United States Court of Appeals

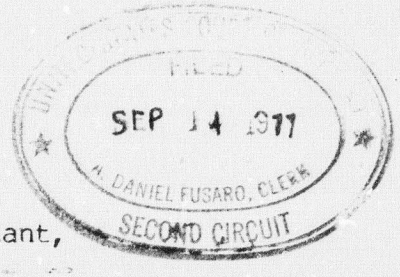
for the Second Circuit

AMICUS BRIEF

77-7192

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 77-7192



HAROLD AMES,

Plaintiff-Appellant,

v.

MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. AND CHRISTOPHER V. STREIT,

Defendants-Appellees.

On Appeal from the United States District Court for the Southern District of New York

76 Civ. 3085-CSH

MEMORANDUM OF THE COMMODITY FUTURES TRADING COMMISSION, AMICUS CURIAE

JOHN G. GAINE
General Counsel

RICHARD E. NATHAN
Deputy General Counsel

JOANNE LEVEQUE
Assistant General Counsel

Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D. C. 20581

INDEX

	Page
TABLE OF AUTHORITIES	i
INTRODUCTION	1
THE INTEREST OF THE COMMODITY FUTURES TRADING COMMISSION	3
STATEMENT	3
ARGUMENT	12
RULE 180.3(b) DOES NOT APPLY TO DISPUTES THAT AROSE PRIOR TO ITS EFFECTIVE DATE: THE RULE DOES APPLY WITH RESPECT TO ALL DISPUTES AFTER ITS EFFECTIVE DATE, AND THERE IS NO CONSTITUTIONAL REASON WHY THE RULE SHOULD BE CONSTRUED OTHERWISE.	
CONCLUSION	18
SUPPLEMENTAL APPENDIX	1sa

TABLE OF AUTHORITIES

Cases	Page
ANA Small Business Investments, Inc. v. Small Business Administration, 391 F.2d 739 (9th Cir. 1968)	15
Booth v. Peavy & Company Commodity Services, 430 F.2d 132 (8th Cir. 1970)	6
Brewster v. Gage, 280 U.S. 327 (1930)	12
Case & Co., Inc. v. Board of Trade of the City of Chicago, 523 F.2d 355 (1975)	6
Chase Securities Corp. v. Donaldson, 325 U.S. 304 (1945)	12
Claridge Apartments v. Commission of Internal Revenue, 323 U S. 14 (1944)	12
Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949)	12
DeVeau v. Braisted, 363 U.S. 144 (1960)	16
Federal Housing Administration v. Darlington, Inc., 358 U.S. 84 (1958)	14, 15
Fleming v. Nestor, 363 U.S. 603 (1960)	16
Fleming v. Rhodes, 331 U.S. 100 (1947)	14
Galvan v. Press, 347 U.S. 522 (1954)	12
Gelfert v. National City Bank of New York, 313 U.S. 221 (1941)	14, 17
Goodman v. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967)	6
Green v. United States, 376 U.S. 149 (1964)	12, 13
Guaranty Trust Co. of New York v. Henwood, 307 U.S. 247 (1939)	14
Harisiades v. Shaughnessy, 342 U.S. 580 (1952)	12

Cases (continued) Page

Herman Schwabe, Inc. v. United Shoe Machinery Corp., 274 F.2d 608 (2d Cir.), cert. denied, 363 U.S. 811 (1960) 12

Home Building & Loan Association v. Blaisdell, 290 U.S. 398 (1934) 14

Montana Power Co. v. Federal Power Commission, 445 F.2d 739 (D.C. Cir. 1970), cert. denied, 400 U.S. 1013 (1970) 12, 17

Norman v. Baltimore & Ohio Railroad Co., 294 U.S. 240 (1935) 14

Philadelphia, Baltimore & Washington Railroad Company v. Schubert, 224 U.S. 603 (1912) 14

Sinking Fund Cases, 99 U.S. 700 (1878) 12

Seligson v. New York Produce Exchange, 378 F. Supp. 1075 (S.D.N.Y. 1974) 6

Smith v. United States, 312 F.2d 119 (10th Cir. 1963) 16

Sproles v. Binford, 286 U.S. 374 (1932) 14

South Terminal Corporation v. Environment Protection Agency, 504 F.2d 646 (1st Cir. 1974) 16

Veix v. Sixth Ward Building & Loan Association of Newark, N.J., 310 U.S. 32 (1940) 14

Wright v. Union Central Life Insurance Co., 304 U.S. 502 (1938) 14

Statutes and Rules: Page

Commodity Exchange Act, as amended, 7 U.S.C. §1 et seq. (Supp. V, 1975):

Section 2(a)(1), 7 U.S.C. §2 (Supp. V, 1975)	4, 5
Section 4, 7 U.S.C. §6	4
Section 4b, 7 U.S.C. §6b (Supp. V, 1975)	1
Section 4d, 7 U.S.C. §§6d (Supp. V, 1975)	5
Section 4e, 7 U.S.C. §6e (Supp. V, 1975)	5
Section 4f, 7 U.S.C. §6f (Supp. V, 1975)	5
Section 4g, 7 U.S.C. §6g (Supp. V, 1975)	5
Section 4k, 7 U.S.C. §6k (Supp. V, 1975)	5
Section 4m, 7 U.S.C. §6m (Supp. V, 1975)	5
Section 4n, 7 U.S.C. §6n (Supp. V, 1975)	5
Section 4o, 7 U.S.C. §6o (Supp. V, 1975)	1, 5
Section 5, 7 U.S.C. §7 (Supp. V, 1975)	4
Section 5a, 7 U.S.C. §7a (Supp. V, 1975)	4, 6
Section 8a(5), 7 U.S.C. §12a(5) (Supp. V, 1975)	9, 13
Section 14, 7 U.S.C. §18 (Supp. V, 1975)	6

Rules Under the Commodity Exchange Act:

Rule 17 C.F.R. §180.3(b)	3, et passim
40 Fed. Reg. 34152-54 (August 14, 1975)	7
40 Fed. Reg. 54432-33 (November 24, 1975)	7
41 Fed. Reg. 6120 (February 11, 1976)	7
41 Fed. Reg. 27526-28 (July 3, 1976)	8, 13
41 Fed. Reg. 42942-47 (September 29, 1976)	3, 8, 9, 13

MISCELLANEOUS

U. S. Const. art. I §10	12
Federal Arbitration Act, 9 U.S.C. §3	2
Transcript of the Commodity Futures Trading Commission, Oral Hearing on Arbitration and Other Dispute Settlement Procedures, March 5, 1976	7, 8
2 Sutherland, Statutory Construction, (4th ed.)(1973)	15

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 77-7192

HAROLD AMES,

Plaintiff-Appellant,

v.

MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. AND CHRISTOPHER V. STREIT,

Defendants-Appellees.

On Appeal from the United States District Court for the Southern District of New York

76 Civ. 3085-CSH

MEMORANDUM OF THE COMMODITY FUTURES TRADING COMMISSION, AMICUS CURIAE

Harold Ames is appealing from an order entered by the United States District Court for the Southern District of New York on March 21, 1977; the order stayed, pending arbitration of his claim, the proceedings in a damage action Mr. Ames had instituted.

Mr. Ames commenced this action on July 13, 1976, seeking money damages of $125,000 based upon alleged violations of the anti-fraud provisions of Sections 4b and 4o of the Commodity Exchange Act, as amended, 7 U.S.C. §§6b and 6o (Supp. V, 1975), by defendants Merrill, Lynch, Pierce, Fenner & Smith, Inc., and Christopher Streit, an account executive in a Merrill Lynch office in New York. In his complaint

(7a-18a)[1], Mr. Ames alleged that between January 1976 and May 1976 the defendants had cheated, defrauded, and deceived him in connection with their handling of his commodity futures account. He alleged that the defendants had churned his account, had engaged in unauthorized trading contrary to his instructions, and had given him false reports concerning the status of his account.

On November 26, 1975, when he opened his account, Mr. Ames had signed a standard form customer's agreement that Merrill Lynch required all its customers to sign. The agreement contained the following clause:

> "It is agreed that any controversy between us arising out of your business or this agreement, shall be submitted to arbitration conducted under the provisions of the Constitution and Rules of the Board of Governors of the New York Stock Exchange . . . ." (18a)

Based upon this provision, on September 3, 1976, defendants Merrill Lynch and Mr. Streit moved the court below, in the alternative, either to dismiss the complaint for lack of subject matter jurisdiction or to stay the judicial proceeding and compel arbitration pursuant to the Federal Arbitration Act, 9 U.S.C. §3. In response, Mr. Ames contended that pre-dispute arbitration clauses were not enforceable in response to claims under the Commodity Exchange Act, 7 U.S.C. §2, et seq. (Supp. V, 1975). On March 21, 1977, the district court issued a memorandum opinion and order, granting the defendant's application to stay the proceeding (36a-57a). This appeal followed.

1/ "Ames Br. ___" refers to pages of the appellant's brief; "ML Br. ___" refers to pages in the appellees' brief; "___a" refers to pages of the appendix included with the Ames brief; "___sa" refers to pages of the supplemental appendix included with this brief.

THE INTEREST OF THE COMMODITY FUTURES TRADING COMMISSION

The Commodity Futures Trading Commission is the agency established by Congress to administer and enforce the provisions of the Commodity Exchange Act and to regulate the activities of commodity futures industry professionals, such as Merrill Lynch and Mr. Streit, and their relationships with their customers. In the performance of these responsibilities, and following an examination of commodity industry practices concerning the use of arbitration, the Commission on September 29, 1976, adopted a rule governing the use of predispute arbitration clauses--contractual provisions by which the parties agree in advance to arbitrate disputes that have not yet arisen. This rule, 17 C.F.R. §180.3(b), 41 Fed. Reg. 42946-42947 (September 29, 1976), was designed to "assure [that] customers . . . do not unknowingly or involuntarily waive rights and remedies available under the Commodity Exchange Act" (11sa).

In the court below and before this Court, the parties have expressed their views concerning the relevance of Rule 180.3(b) to the case at bar. In addition, the district court reached certain conclusions in this regard. Particularly in light of statements made by the district court, which the Commission believes might be misapplied to the detriment of numerous commodity futures customers, the Commission submits this brief as amicus curiae.

STATEMENT

1. On October 23, 1974, Congress enacted the Commodity Futures Trading Commission Act of 1974, 88 Stat. §1389, et seq., which extensively amended the Commodity Exchange Act and created the Commission,

effective April 21, 1975, to administer and enforce that Act's provisions.[2/] As amended, the Commodity Exchange Act provides a comprehensive scheme of regulation with respect to commodity futures and related markets and confers broad enforcement and regulatory powers upon the Commission.

The main area of Commission responsibility relates to contracts of sale of commodities for future delivery traded or executed on boards of trade--i.e., commodity exchanges. Under Section 4 of the Commodity Exchange Act, 7 U.S.C. §6 (Supp. V, 1975), it is generally unlawful to effect a commodity futures transaction other than by or through a member of a board of trade that has been designated by the Commission as a "contract market" for a particular commodity futures contract. Rigid standards must be met by a board of trade in order to obtain designation as a "contract market",[3/] and once it has been designated as a contract market, it must comply with specific standards contained in the Act relating to its continued operation, including the prevention of fraud, manipulation and other trading abuses.[4/]

2/ Prior to the 1974 amendments, the Act had been administered by the Commodity Exchange Authority of the Department of Agriculture, and applied only to trading in certain specifically enumerated agricultural commodities. The 1974 amendments greatly expanded the coverage of the Act to encompass virtually all previously unregulated commodities and vested in the Commission "exclusive jurisdiction" to regulate "accounts, agreements . . ., and transactions involving contracts of sale of a commodity for future delivery. . . ." Section 2(a)(1) of the Act, 7 U.S.C. §2 (Supp. V, 1975).

3/ See Section 5 of the Act, 7 U.S.C. §7 (Supp. V, 1975).

4/ See Section 5a of the Act, 7 U.S.C. §7a (Supp. V, 1975).

In addition, various professional participants in the commodity markets, including futures commission merchants[5/] and commodity trading advisors,[6/] such as Merrill Lynch, must register with the Commission[7/] and are subject to antifraud, reporting, recordkeeping, net capital and other provisions of the Act.[8/] Persons associated with futures commission merchants, such as Mr. Streit, are also required to register.[9/]

2. Although, prior to 1974, the Commodity Exchange Act did not contain any express remedy for persons injured as a result of violations of the Act, the courts recognized an implied right of action that could

---

5/ A "futures commission merchant" is defined in Section 2(a)(1) of the Act, 7 U.S.C. §2 (Supp. V, 1975) as an individual or entity "engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom."

6/ A "commodity trading advisor" is defined in Section 2(a)(1) of the Act, 7 U.S.C. §2 (Supp. V, 1975) as a person "who for compensation or profit, engages in the business of advising others, either directly or through publications or writings, as to the value of commodities or the advisability of trading in any commodity for future delivery on or subject to the rules of any contract market, or who for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning commodities . . . ."

7/ See Sections 4d, 4e, 4f, 4m and 4n of the Act, 7 U.S.C. §§6d, 6e, 6f, 6m and 6n (Supp. V, 1975).

8/ See Sections 4d, 4f, 4g, 4m, 4n and 4o of the Act, 7 U.S.C. §§6d, 6f, 6g, 6m, 6n and 6o (Supp. V, 1975).

9/ See Section 4k of the Act, 7 U.S.C. §6k (Supp. V, 1975).

be pursued in federal district court.[10/] The 1974 amendments to the Commodity Exchange Act, which created the Commission, also established the Commission as a quasi-judicial administrative forum for the adjudication of complaints by members of the public who claim to have been injured as a result of unlawful activities by any of the classes of commodity industry professionals required to register under the Act. Thus, Section 14 of the Act, 7 U.S.C. §18 (Supp. V, 1975), authorizes the Commission to render a reparation award requiring a futures commission merchant, commodity trading advisor or other industry professional to compensate a complainant for any injury he has sustained as a result of the registrant's violation of the Act.

At the same time, Congress expressly recognized that arbitration might be used to resolve disputes between industry professionals and their customers. In Section 5a(11) of the Act, 7 U.S.C. §7a(11) (Supp. V, 1975), Congress required all contract markets to establish a "fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof." That section explicitly provides, however, that "the use of such procedure by a customer shall be voluntary . . . ."

3. Shortly after its creation, the Commission undertook an examination of the use of arbitration in the futures industry. It became

---

10/ See, e.g., Case & Company, Inc. v. Board of Trade of the City of Chicago, 523 F.2d 355, 360 (7th Cir. 1975); Booth v. Peavy Company Commodity Services, 430 F.2d 132, 133 (8th Cir. 1970); Seligson v. New York Produce Exchange, 378 F. Supp. 1076, 1084 (S.D.N.Y. 1974); Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967).

apparent that arbitration was frequently conducted not under the auspices of the contract markets regulated by the Commission but through other organizations, including, in the case of firms such as Merrill Lynch, which are active in both the commodities and securities businesses, arbitration sponsored by the New York Stock Exchange or other securities-oriented organizations (11sa). It also became apparent that in many cases arbitration was not undertaken voluntarily by customers, but that customers instead were compelled to agree to predispute arbitration clauses as a precondition to doing business (11sa, 17sa). Indeed, this practice was found to be so prevalent that a customer might effectively be frozen out of the futures market should he or she refused to execute a predispute agreement (11sa, 17sa). Moreover--and of equal concern to the Commission--many customers were not in fact aware of this contractual provision, or of its implications, until a dispute subsequently arose and the futures commission merchant invoked the arbitration clause (6sa-7sa).

4. The Commission initially proposed to ban all predispute arbitration clauses and to allow arbitration only if agreed to by both parties after the claim arose. See 40 Fed. Reg. 34152-54 (August 14, 1975)(2sa-3sa); 40 Fed. Reg. 54432-33 (November 24, 1975) (6sa-9sa). The Commission received written comments on these proposals and on March 5, 1976, the Commission received oral testimony from interested parties. See 41 Fed. Reg. 6120 (February 11, 1976). Among the witnesses, was Stephen Metz, a representative of Merrill Lynch, who testified in opposition the Commission's proposal to restrict arbitration.[11/] Under

---

11/ Transcript of the Commodity Futures Trading Commission, Oral Hearing on Arbitration and Other Dispute Settlement Procedures, March 5, 1976 (hereinafter referred to as "Hearings") at 71-98. Pages 82-98 of Mr. Metz' testimony, consisting of questions addressed to him by the Commission, and his responses, are produced at Ames Br. 27-43. Mr. Ames' formal statement, reported at Hearings 71-81, is not reproduced.

questioning, Mr. Metz admitted that if a prospective customer--whether a small individual customer or a large institutional customer--would not agree to the arbitration clause in Merrill Lynch's standard form agreement, the person would probably be turned down as a customer (Hearings, at Ames Br. 32). Mr. Metz testified:

> ". . . If the broker, the account executive comes in to New York and says 'This fellow wants to x out part of the agreement' we will say 'No, he cannot do that'.
>
> ". . . [S]omewhere along the line, maybe an account executive will X it out and agrees with the customer but I'm saying if they come to New York and ask the policy ruling we will tell them that customer will have to sign the agreement as drawn." Ibid. 12/

Following the hearings and after carefully considering all comments received, many of them favorable to arbitration, the Commission modified its earlier proposal. The new proposal recognized the value of arbitration as a mechanism for quick and less expensive resolution of disputes, and thus a vehicle to be encouraged in appropriate cases. It also recognized, however, the need to assure that customers would not, through arbitration, waive rights and remedies otherwise available to them under the Act, either unknowingly or because they were being compelled to do so under penalty of effective exclusion from the market place. Thus, the Commission proposed to permit the continued use of pre-dispute arbitration agreements, but only under conditions designed to assure that arbitration was truly voluntary on the part of the customer. 41 Fed. Reg. 27526-28 (July 3, 1976) (11sa-13sa). Although this proposal

---

12/ This testimony given on behalf of Merrill Lynch was consistent with testimony given by other firms in the industry. See, e.g., testimony of Donald Crawford, Vice President of Shearson Hayden Stone, Inc., Hearings at 32-34, 37 (20sa-23sa). See generally 41 Fed. Reg. 42945 (September 29, 1976) (17sa).

was also opposed by some in the industry, it was ultimately adopted with only minor changes. 41 Fed. Reg. 42942-47 (September 29, 1976) (14sa-19sa).[13/]

5. As adopted, Rule 180.3(b), 17 C.F.R. §180.3(b), permits predispute arbitration agreements to be entered between futures commission merchants and their customers, but only when the agreement is not a condition to a customer's doing business with a firm. The rule also specifically provides that by signing a predispute arbitration agreement a customer will not waive his or her right to seek reparations pursuant to Section 14 of the Act. Moreover, should an arbitration clause be included as part of a broader agreement, that clause must be separately endorsed by the customer, in order to alert the customer to the arbitration provision.

Furthermore, under Rule 180.3(b) each agreement must contain cautionary language, specified in the rule, which is to be printed in large boldface type, informing the customer of his rights and obligations with respect to arbitration. This warning will notify the customer that acceptance of the arbitration clause is voluntary and may not be a precondition to opening an account, that if the arbitration clause is accepted, the customer may be waiving the right to sue in court, and that the right to the reparation remedy, while not waived by the arbitration clause, may be asserted only for a limited time after

---

13/ The rule was adopted under the Commission's general rulemaking authority "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this Act." Section 8a(5), 7 U.S.C. §12a(5) (Supp. V, 1975).

the customer has been notified that the firm intends to submit the dispute to arbitration.

In addition, in adopting Rule 180.3(b) the Commission determined that all predispute arbitration agreements contained in previously executed documents, unless reformed to comply with the rule,[14/] would become null and void on and after November 29, 1976, the effective date of the rule (16sa). The Commission expressly stated that it had considered applying the rule only to agreements entered into after the effective date, but that it had rejected that idea because customers who had entered into agreements earlier needed and were entitled to the protections of the rule no less than those customers who signed after November 29, 1976 (16sa, n. 18).

6. The Commission's Rule 180.3(b) became effective after the events which are the subject matter of the complaint. Mr. Ames argued, among other things, that the rule should nevertheless be applied retroactively to his dispute with the defendants, basing his contention on the announcement by the Commission, when it adopted the rule, that arbitration agreements entered into before the effective date of the rule, which were not thereafter revised to comply with the requirements of the rule, would be null and void.

The issue whether Rule 180.3(b) should apply to disputes such as Mr. Ames' that arose prior to its effective date is, of course, of

---

14/ The inconvenience to futures commission merchants and other registrants of having to obtain new agreements was not a sufficient basis to discriminate between the two groups of customers, the Commission found. The Commission suggested, however, that with respect to existing agreements, firms might address a "negative option letter" to each customer, setting forth the requirements of the rule and stating that the contract was deemed modified to accord with the requirements of Rule 180.3(b), unless the customer responded negatively within a stated period of time after receipt of the letter (17sa).

only short-term interest, and presumably affects the interests of only a relatively few persons. Accordingly, it is not a question concerning which the Commission would ordinarily wish to express its views as amicus curiae. But the district court's opinion, although recognizing and approving of the Commission's objectives in adopting the rule (46a), contains broad language which, if removed from the context of this case, might be read to deny to many commodity futures customers for an indefinite period the remedial protections that the rule was intended to afford.

Although the district court was considering only the retroactive application of Rule 180.3(b) to a claim arising before its effective date, the court broadly stated (49a):

> "Because I believe that retrospective application of §180.3 would serve to prejudice heretofore valid agreements entered into on the basis of existing legal authority, I decline to apply §180.3 retroactively which would perforce require this Court to deny the benefits of the arbitration provision set forth in the Customer's Agreement, based on language not in existence when the contract was made."

This unfortunate choice of words could be construed to mean that all customers who had entered into agreements prior to the effective date of Rule 180.3(b) would continue to be bound by an agreement that does not comply with the rule, not only as in the instant case, with respect to disputes that arose before the rule became effective, but also with respect disputes arising after the rule's effect date. This appears to the construction that Merrill Lynch is urging this Court to adopt when it argues for a negative response to the question

> ". . . whether Reg. §180.3 should be given effect retroactively to void a valid predispute arbitration agreement entered into prior to its effective date . . . ." (ML Br. 3).

ARGUMENT

RULE 180.3(b) DOES NOT APPLY TO DISPUTES THAT AROSE PRIOR TO ITS EFFECTIVE DATE; THE RULE DOES APPLY WITH RESPECT TO ALL DISPUTES AFTER ITS EFFECTIVE DATE, AND THERE IS NO CONSTITUTIONAL REASON WHY THE RULE SHOULD BE CONSTRUED OTHERWISE.

When a substantive provision of law is applied prospectively, i.e., affects only conduct and events arising after its effective date, due process considerations--questions of fairness--are unlikely to arise, since conduct can be adjusted prospectively to comply with the new requirements.[15/] Retrospective application of a statute or rule can, however, raise due process considerations, although the mere fact or retroactivity does not, standing alone, make it unconstitutional. Chase Securities Corp. v. Donaldson, 325 U.S. 304, 315 (1945); Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 554 (1949). Absent a strong showing of contrary intent, the courts have generally construed substantive legislation and rules to apply prospectively only. Greene v. United States, 376 U.S. 149, 160 (1964); Claridge Apartments v. Commission of Internal Revenue, 323 U.S. 141, 164 (1944); Brewster v. Gage, 280 U.S. 327, 337 (1930); Herman Schwabe, Inc. v. United Shoe Machinery Corp., 274 F.2d 608, 610 (2d Cir.), cert. denied, 363 U.S. 811 (1960).[16/]

15/ Any challenge to the Commission's rule must rest upon the general standard of fundamental fairness under the due process clause. The prohibition of ex post facto laws applies only to penal legislation. Galvan v. Press, 347 U.S. 522, 531 (1954); Harisiades v. Shaughnessy, 342 U.S. 580, 594-595 (1952). The prohibition against impairment of contracts under Article 1, §10 of the Constitution applies only to the states. Sinking Fund Cases, 99 U.S. 700, 718 (1878).

16/ Generally, procedural or remedial statutes may be given retroactive application since they do not involve vested rights. See, e.g., Montana Power Co. v. Federal Power Commission, 445 F.2d 739,(D.C. Cir. 1970), cert. denied, 400 U.S. 1013 (1971).

While the Commission, in the adoption of Rule 180.3(b), has provided that all arbitration clauses not complying with the provisions of Rule 180.3(b) would be null-and-void as of November 29, 1976, the requirements of the rule, except in situations involving reparations,[17/] were intended to be effective only concerning disputes that had not arisen prior to that date. Cf., Greene v. United States, supra, 376 U.S. at 160. Thus, the only element of unfairness that might otherwise have arguably been involved in the enforcement of the Commission's rule was eliminated.[18/]

Insofar as the Commission's rule applies prospectively to govern the resolution of all disputes arising after its effective date, firms were given two months after the adoption of Rule 180.3(b), as a reasonable period in which to bring their agreements into conformity with the rule's specific requirements. Thereafter, disputes which subsequently arose would be encompassed by the protections of Rule 180.3(b) and this was to be true regardless of any prior agreements to the contrary.

It was well within the Commission's authority to adopt such a rule. See Section 8a(5), 7 U.S.C. §12(a)(5). Moreover, contrary to the

---

17/ Because of the role of reparations in the statutory scheme under the Commodity Exchange Act, and the special responsibilities of the Commission in this respect, different considerations have applied when a customer wishes to use the reparations procedure while the registrant seeks to arbitrate. See, e.g., 41 Fed. Reg. 27528 (13sa).

18/ At the same time, the Commission did express the view that, without the remedial protections afforded by Rule 180.3(b), the courts would likely have held predispute arbitration agreements unenforceable in any event, based upon the same legal and policy considerations which led the Commission to adopt Rule 180.3(b). See 41 Fed. Reg. 42944-45 (16sa-17sa). Accordingly, the position expressed by the Commission in this brief concerning the intended impact of its rules should not be construed to imply that the Commission believes that the agreement signed by Mr. Ames was necessarily enforceable prior to November 29 merely because Rule 180.3(b) was inapplicable at the time.

apparent contentions of Merrill Lynch (ML Br. 13, 3), the rule suffers no constitutional infirmity merely because, in order to serve public purposes, the rule affects the future enforcement of established private contractual relationships. As the Supreme Court has stated:

> "Federal regulation of future action based on rights previously acquired by the person regulated is not prohibited by the Constitution. So long as the Constitution authorizes the subsequently enacted legislation, the fact that its provisions limit or interfere with previously acquired rights does not condemn it. Immunity from federal regulation is not gained through forehanded contracts."

Fleming v. Rhodes, 331 U.S. 100, 107 (1947) (emphasis added). See also, Federal Housing Administration v. Darlington, Inc., 358 U.S. 84, 91 (1958).

Thus, in Home Building & Loan Association v. Blaisdell, 290 U.S. 398, 434-435 (1934), a challenge based upon the constitutional prohibition against state laws impairing the obligation of contracts, the Supreme Court stated (emphasis added; footnotes and citations omitted):

> "Not only is the constitutional provision qualified by the measure of control which the state retains over remedial processes, but the state also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end 'has the result of modifying or abrogating contracts already in effect'. Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order."

See also, e.g., Gelfert v. National City Bank of New York, 313 U.S. 221, 233-234 (1941); Veix v. Sixth Ward Building & Loan Association of Newark, N.J., 310 U.S. 32, 38 (1940); Guaranty Trust Co. of New York v. Henwood, 307 U.S. 247, 259 (1939); Wright v. Union Central Life Insurance Co., 304 U.S. 502, 516 (1938); Norman v. Baltimore & Ohio Railroad Co., 294 U.S. 240, 308-310 (1935); Sproles v. Binford, 286 U.S. 374, 390-391 (1932); Philadelphia, Baltimore & Washington Railroad Company v. Schubert, 224 U.S. 603, 613-614 (1912).

These principles apply equally to administrative rulemaking, as to Congressional legislation. It follows that "a licensee under a scheme of federal regulation acquires no vested rights which immunize it from reasonable regulation by an administrative agency." ANA Small Business Investments, Inc. v. Small Business Administration, 391 F.2d 739, 746 (9th Cir. 1968). See also, Federal Housing Administration v. Darlington, Inc., supra, 358 U.S. at 91.

Merely to characterize uncritically as "retroactive"[19/] any application of Rule 180.3(b) to disputes arising after its effective date, as Merrill Lynch has done (ML Br. 13), begs the important question of basic fairness that these numerous authorities have resolved in favor of the type of prospective application and enforcement of Rule 180.3(b) that the Commission intended.

Thus, activities which were lawful at one time may, by virtue of a subsequently adopted rule or statute, be rendered unlawful if continued. A rule that so provides is constitutional so long as it does not punish conduct before its effective date, but only requires that the rule be honored once it becomes effective. See, e.g., Federal Housing Administration v. Darlington, Inc., supra, 358 U.S. at 91; ANA Small Business Investments, Inc. v. Small Business Administration, supra, 391 F.2d at 746. Indeed, where the primary purpose of subsequently adopted legislation is in furtherance of a valid regulatory scheme, rather than to punish wrongdoers, even statutory provisions imposing disabilities or other adverse consequences

---

19/ In one sense, of course, "any law which changes the sum total of rights, power, privileges, and immunities of people generally or changes the balance of them between people, which is what all laws do in one way or another, has retroactive effect insofar as rights, etc., adhering before an act was passed are not the same afterwards." 2 Sutherland Statutory Construction, §41.02, p. 248 (4th ed. 1973).

for past conduct have been sustained. See, e.g., Fleming v. Nestor, 363 U.S. 603, 616 (1960); DeVeau v. Braisted, 363 U.S. 144, 161 (1960). Cf., Smith v. United States, 312 F.2d 119 (10th Cir. 1963).[20/]

While the district court suggested that it might be unfair to Merrill Lynch if the Commission's rule were applied retroactively, the district court's analysis of possible prejudice has meaningful application only if the rule were to be enforced concerning disputes that arose before its effective date. The district court considered application of the rule unfair in that situation, since a customer's agreement which was signed before the rule was adopted could not have been expected to have included the specific cautionary language required by Rule 180.3(b)(4) (47a-49a). As applied to subsequent matters, however, commodity futures firms had two months before the rule became effective to take the simple steps necessary to assure that their contracts would comply prospectively with its requirements. Thus, the district court's reasoning has no application to the situation where, in contrast to the case at bar, the cause of action arose at a point where there was ample time to modify the agreement to include the required language.

20/ See also, South Terminal Corporation v. Environmental Protection Agency, 504 F.2d 646 (1st Cir. 1974), where the company argued that an air pollution control plan improperly affected substantially vested property rights by imposing restrictions which would interfere with the proposed use of a building already under construction at the time the plan was adopted. The court responded (id. at 678):

> "The regulations do not penalize South Terminal for any conduct which, when engaged in, was permitted. At most they abrogate, for the future only, expectations South Terminal may have acquired in the past. But all changes in the law dash expectations when they make tomorrow's rules different from yesterday's; that is not enough to create a 'retroactive' law . . . ."

In discussing the potential unfairness if Rule 180.3(b) were applied retroactively, the district court also noted twice the possibility that an arbitration clause might have been entered into voluntarily ab initio (47a, 49a). Rule 180.3(b)(1) provides that "signing the agreement must not be made a condition for the customer to utilize the services offered by the futures commission merchant . . . ." But a person who had earlier agreed to a predispute arbitration clause, fully aware of the implications of this clause and faced with an effective choice whether to agree or not, would likely reaffirm his or her consent at the time the Commission's rule became effective, with no prejudice to a registrant. On the other hand, if a customer had not previously given a free and informed consent, and were now unwilling to agree to a predispute clause, a futures commission merchant could hardly claim that it would be deprived of a vested interest if stripped of its ability to enforce its contract of adhesion to compel arbitration. Cf., Gelfert v. National City Bank of New York, supra, 313 U.S. at 232-234.[21/] In any event, the probability that Merrill Lynch had entered any purely voluntary arbitration agreement is particularly remote; in the case of Merrill Lynch, as we have seen (supra, p. 8), its representative testified before the Commission that the firm would refuse to deal with any persons unwilling to accept the standard form arbitration clause.

21/ An arbitration clause buried in a customer's agreement was likely not bargained for between the parties and, accordingly, should not be construed as granting a vested right of a nature that it would prevail over a remedial rule adopted by the Commission. Cf., Montana Power Company v. Federal Power Commission, supra, 445 F.2d at 750.

CONCLUSION

For the foregoing reasons, Rule 180.3(b) should be held inapplicable to disputes arising prior to its effective date. Rule 180.3(b) should be construed, however, consistent with the Commission's intent, to grant all customers the intended remedial protections with respect to all disputes arising after the effective date of the rule--including those customers who had previously entered into agreements which did not comport with the terms of the rule.

Respectfully submitted,

JOHN G. GAINE
General Counsel

RICHARD E. NATHAN
Deputy General Counsel

JOANNE LEVEQUE
Assistant General Counsel

Commodity Futures Trading Commission
2033 K Street, N. W.
Washington, D. C. 20581

Dated: August 19, 1977

[17 CFR Part 200]

ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES

Proposed Provisions

On July 10, 1975, the Commodity Futures Trading Commission published an interpretative statement setting forth the Commission's responses to six questions by exchanges, boards of trade, and other interested persons which concerned the requirements of Section 5a(11) of the Commodity Exchange Act, 7 U.S.C. 7a (11), as added by Section 209 of the Commodity Futures Trading Commission Act of 1974, Pub. L. 93-463, § 209, 88 Stat. 1401 (1974). *See* 40 FR 29121 (July 10, 1975). In order to assure prompt compliance with the Commission's interpretative statement and other requirements of Section 5a(11), the Commission has determined to propose rules setting forth affirmative provisions to be followed by contract markets. If adopted, the rules will comprise a new Part 200 of Title 17 of the Code of Federal Regulations.

The Commission invites public comment on the proposed rules. The Commission will consider comments received with respect to its prior interpretative statement as a part of this rulemaking proceeding.

Statute and Summary. Section 5a(11) requires each contract market to:

> Provide a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof: *Provided*, That (i) the use of such procedure by a customer shall be voluntary, (ii) the procedure shall not be applicable to any claim in excess of $15,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties, and (iv) the term 'customer' as used in this subsection shall not include a futures commission merchant or a floor broker. * * *

The following is a summary of the rules proposed by the Commission:

1. Proposed new Rule § 200.1 defines the terms "customer" and "customers" as used in Section 5a(11). In summary, the definition describes a customer as a person engaging in a transaction through the facilities of a contract market other than in the capacity of a futures commission merchant or a floor broker.

2. Proposed new Rule § 200.2 sets forth the procedural requirements that must be contained in the rules of a contract market to establish, as required by Section 5a(11), a "fair and equitable procedure" for settlement of customers' claims and grievances. For the most part, the procedures required by this rule are those set forth in the Commission's response to Question 1 in the interpretative statement previously published in the FEDERAL REGISTER. See 40 FR 29121. The proposed rule requires that customers be provided an "impartial" arbitration panel or other decision-making body ("panel"). Such a panel may be composed entirely of exchange members, but the customer must be given an election to submit the claim or grievance to a panel composed of at least a majority of persons who are not associated with any member of the contract market or employee thereof, and who are not otherwise associated with the contract market. The proposed rule also would prohibit a contract market from requiring a transcript unless agreed to by the customer or unless the customer is not assessed with the expense of the transcript. This requirement is designed to assure that customers with claims under $15,000 are not discouraged from

using the settlement procedure required by Section 5a(11) because of possibly expensive transcript costs. Also, the proposed rule provides that there shall be no right of contract-market related appeal as, for example, an appeal to the Board of Governors of the contract market or to any other entity; the only right of appeal being as provided under applicable law. One brokerage firm has commented that procedural protections should be extended to all participants in any proceeding brought under Section 5a(11). The Commission believes such a requirement is implicit in its proposed rules, but requests additional comment on the need for more explicit protections for participants other than customers, as well as customers. The proposed rule further requires adequate notice of the amount or nature of any fees or costs which may be assessed against customers utilizing the procedure and requires that any such costs be reasonable in relation to the claim or grievance. The Commission requests comment on the manner in which costs should be allocated and how costs for small claims or grievances should be dealt with.

3. Proposed new Rule § 200.3 sets forth the views expressed by the Commission in response to Question 3 in its prior interpretative statement and imposes additional requirements, *cf.*, 40 FR 29121. Among other things, the proposed rule prohibits any agreement between persons registered under the Commodity Exchange Act and a customer, in which the customer agrees to submit claims or grievances pertaining to any matter or transaction subject to the jurisdiction of the Commission to any settlement procedure, prior to the time a claim arises. The proposed rule would authorize a settlement procedure in which customers would agree, prior to the time of an award, to be bound by the award, so long as the agreement to be bound was made after the claim or grievance arose. In addition, any agreement by a customer to submit a claim or grievance to a settlement procedure must be voluntary and must not be subject to any unreasonably short limitation period. For example, a limitation period foreclosing customers' claims and grievances from submission to the procedure unless submitted within 90 days after the claim or grievance arose is not, in the Commission's view, reasonable. On the other hand, a limitation period of two years from the time a claim or grievance arose would appear reasonable.

4. Proposed new Rule § 200.4 sets forth the circumstances under which a counterclaim by a member of a contract market or employee thereof, could be made against a customer under a settlement procedure established pursuant to Section 5a(11). The proposed rule adopts the views expressed by the Commission in response to Question 2 in its prior interpretative statement. *See* 40 FR 29121. Briefly, contract market rules could permit a member's counterclaim where the counterclaim arises out of the transaction or occurrence that is the subject of a customer's claim and does not require for adjudication the presence of third parties over whom the contract market does not have jurisdiction. Also, such counterclaims must not be for an amount in excess of $15,000. The Commission has received comment from one board of trade, which urged that counterclaims be allowed beyond indebtedness arising out of the same transaction or occurrence on which a customer's claim or grievance is based. In this connection, the proposed rule would permit such other counterclaims only if the customer agrees to arbitrate the counterclaim after the counterclaim has arisen, and if the counterclaim is less than $15,000. The Commission requests additional comment on whether the consent of the customer should be required for counterclaims that do not arise out of the same transaction or occurrence as the customer's claim or grievance.

5. Proposed new Rule § 200.5 sets forth the views expressed by the Commission in its responses to Questions 4 and 5 contained in its prior interpretative statement. *See* 40 FR 29121. The proposed rule would permit a contract market to establish a procedure for settlement of customers' claims and grievances which are not covered by Section 5a(11) (*e.g.*, claims for amounts involving more than $15,000). Such a procedure would be required to be independent of and could not interfere with or delay the resolution of customers' claims submitted under the procedure required by Section 5a(11). Also, the proposed rule states that the procedure must be fair and equitable and voluntary. The Commission has received comments from one board of trade which expressed the view that Section 5a(11) should not be expanded to permit contract markets to establish a procedure for the settlement of customers' claims or grievances in amounts in excess of $15,000, since, in the view of the board of trade, claims over $15,000 are significant enough to require all formal safeguards available in a court of law. The Commission requests additional comment on this question, but has added to this rule a requirement that where a claim or grievance exceeds $15,000 the customer must be warned in writing in advance of submission to the procedure that all procedures applicable in a court of law may not be available; and the contract market must be able to establish that, notwithstanding such formal warning, the customer voluntarily submitted the dispute to the procedure.

6. Proposed new Rule § 200.6 sets forth the views expressed by the Commission in its response to Question 6 in its prior interpretative statement. *See* 40 FR 29121. Specifically, the proposed rule would permit a contract market to establish a dispute resolution procedure for claims in which a customer is not involved (*e.g.*, the resolution of a dispute involving only futures commission merchants or floor brokers). This procedure would also be required to be independent of, and could not interfere with or delay the resolution of customers' claims or grievances submitted under the procedure required by Section 5a(11). This proposed rule would provide that the procedure must establish safeguards conforming to traditional concepts of due process and would include the formal warning set forth in paragraph 5 above.

The following rules are proposed by the Commodity Futures Trading Commission pursuant to authority contained in Sections 5a(11) and 8a of the Commodity Exchange Act, as amended, 7 U.S.C. 7a(11) and 12a.

PART 200—ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES

Sec.

200.1 Definition of customer.
200.2 Fair and equitable procedure.
200.3 Voluntary procedure and compulsory payments.
200.4 Counterclaims.
200.5 Other customer claims and grievances.
200.6 Member-to-member settlement procedures.

AUTHORITY: Secs. 5a(11), 8a, Commodity Exchange Act, as amended, 7 U.S.C. 7A(11), 12a.

§ 200.1 Definition of customer.

The terms "customer" and "customers" as used in Section 5a(11) of the Commodity Exchange Act, 7 U.S.C. § 7a(11), as amended, shall mean any person engaging in any transaction executed through the facilities of a contract market. The terms "customer" and "customers" do not include a futures commission merchant or floor broker as defined in the Commodity Exchange Act, 7 U.S.C. § 1, *et seq.*, unless such persons were not acting in the capacity of a floor broker or futures commission merchant in connection with a claim or grievance they seek to submit to a settlement procedure required by Section 5a(11).

§ 200.2 Fair and equitable procedure.

Every contract market shall, in conformance with section 5a(11) of the Commodity Exchange Act, 7 U.S.C. 7a(11), as amended, adopt rules which provide for a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof, which arise on or after the effective date of section 5a(11). The procedure shall not be applicable to any claim or grievance in excess of $15,000. The rules shall include at least the following as minimum requirements for a fair and equitable procedure:

(a) The procedure shall be impartial. Customers must be provided the option of having a majority of any panel or decision-making body acting as arbitrators or otherwise acting to settle customers' claims and grievances to be composed of persons who are not members or associated with any member of the contract market or employee thereof and who are not otherwise associated with the contract market.

(b) The procedure shall grant customers the right to be represented by counsel in any aspect of the procedure.

(c) The procedure shall provide for prompt settlement of customer claims and grievances and shall not allow unnecessary or unreasonable delay.

(d) The procedure shall require adequate notice to customers and opportunity for a prompt hearing as follows:

(1) Customers shall be entitled personally to appear at such hearings.

(2) The formal rules of evidence need not apply at the hearing. Nevertheless, the procedures established may not be so informal as to deny due process. Customers must be given adequate opportunity to prepare and present all relevant facts in support of their claims or grievances, and to present rebuttal evidence to any defenses made by the person against whom the claim or grievance has been brought.

(3) Customers shall be entitled to cross-examine persons against whom a claim or grievance is brought and any witnesses appearing at the hearing and to examine all relevant documents presented in connection with the claim or grievance.

(4) A transcript shall not be required, unless the customer making the claim or grievance so agrees or unless the customer is not assessed with the cost of the transcript.

(5) Provision may be made for customers to waive the right of personal appearance at the hearing through a submission on the basis of written documents. Such a waiver must be voluntary and may be made only after the claim or grievance arose.

(e) The procedure shall provide adequate notice to customers, in advance of submission of a claim or grievance to the procedure, of the amount of any fees or costs and the nature of any fees or costs which may be assessed against customers utilizing the procedure. Fees or costs shall be reasonable, particularly in relation to the claim or grievance presented.

(f) The procedure shall provide that the settlement award shall be rendered promptly in writing and be final. There shall be no right of contract market related appeal; the only right of appeal being as provided under applicable law.

(g) The procedure shall not impose any restrictions on the jurisdiction or venue of any court to enforce an award so rendered.

§ 200.3 Voluntary procedure and compulsory payments.

(a) The use by a customer of the procedure established by a contract market pursuant to section 5a(11) of the Commodity Exchange Act, 7 U.S.C. 7a(11), as amended, for settlement of customers' claims and grievances against any member or employee thereof, shall be voluntary.

(b) The procedure established by a contract market pursuant to section 5a(11), of the Commodity Exchange Act, 7 U.S.C. 7a(11), as amended, for settlement of customers' claims and grievances against a member or employee thereof, shall prohibit any agreement or understanding pursuant to which customers agree to submit claims or grievances for settlement under the procedure so established, prior to the time when the claim or grievance arose.

(c) No futures commission merchant, floor broker, associated person or any other person registered with the Commodity Futures Trading Commission under the Commodity Exchange Act, 7 U.S.C. 1, *et seq.*, shall enter into any agreement or understanding with a customer in which a customer agrees to submit claims or grievances pertaining to any matters or transactions subject to the jurisdiction of the Commission to any settlement procedure prior to the time the claim or grievance arose.

(d) The procedure established by a contract market pursuant to section 5a(11) of the Commodity Exchange Act, 7 U.S.C. 7a(11), as amended, for settlement of customers' claims and grievances against any member or employee thereof, may require customers utilizing such procedure to agree under applicable state law, submission agreement or otherwise to be bound by an award rendered in the procedure, before such award is rendered. However, the customer's agreement to submit the claim or grievance to the procedure must have, in any case, been made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(e) The procedure established by a contract market pursuant to section 5a(11) of the Commodity Exchange Act, 7 U.S.C. 7a(11), as amended, for the settlement of customers' claims and grievances against any member or employee thereof, shall not establish any unreasonably short limitation period foreclosing submission of customers' claims or grievances to the procedure.

§ 200.4 Counterclaims.

A procedure established by a contract market under section 5a(11) of the Commodity Exchange Act, 7 U.S.C. 7a(11), as amended, for the settlement of customers' claims or grievances against a member or employee thereof may permit the submission of a counterclaim in the procedure by a person against whom a claim is brought. The contract market may permit such a counterclaim where the counterclaim arises out of the transaction or occurrence that is the subject of the customer's claim or grievance and does not require for adjudication the presence of third parties over whom the contract market does not have jurisdiction. Such a counterclaim may not be for an amount in excess of $15,000. Other counterclaims are permissible only if the customer agrees to their submission after the counterclaim has arisen, and if the aggregate monetary value of the counterclaim is capable of calculation and is not in excess of $15,000.

§ 200.5 Other customer claims and grievances.

A contract market may establish a procedure for settlement of customers' claims and grievances against any member or employee thereof, which are not covered by section 5a(11) of the Commodity Exchange Act, 7 U.S.C. 7a(11), as amended. The procedure shall be independent of, and shall not interfere with or delay the resolution of, customers' claims or grievances submitted for resolution under the procedure of a contract market established pursuant to the requirements of section 5a(11). Customers must be warned in writing in advance of the submission of the claim or grievance to this procedure that all formal legal safeguards provided in a court of law may not be available to the parties. This warning shall list, to the extent practicable, those safeguards which will be unavailable. If after receipt of such warning, the customer voluntarily agrees to submit the claim or grievance to the procedure, the procedure may go forward: but the procedure must be shown to be voluntary, and must be fair and equitable as defined by rules §§ 200.2 and 200.3 of this chapter.

§ 200.6 Member-to-member settlement procedure.

A contract market may establish a procedure for settlement of claims and grievances which do not involve customers. If adopted, the procedure shall be independent of, and shall not interfere with or delay the resolution of, customers' claims and grievances submitted for resolution under the procedure established pursuant to section 5a(11) of the Commodity Exchange Act, 7 U.S.C. 7a (11), as amended. Submission of such claims to such a procedure must be accompanied by a written warning, in advance of the submission, that all formal legal safeguards provided by a court of law may not be available to the parties. Listing, to the extent practicable, those safeguards which will be unavailable. After receipt of such warning, the parties may voluntarily agree to go forward, but the procedure in such arbitration shall provide sufficient due process safeguards which include, at a minimum, fair and equitable procedures as defined by Rules §§ 200.2 and 200.3 of this chapter, except that the election of panel members contained in Rule § 200.2(a) need not be required.

Interested persons may participate in this proposed rulemaking by submitting comments in written form to the Commodity Futures Trading Commission, 1120 Connecticut Avenue, NW., Washington, D.C. 20036. All comments received on or before September 18, 1975, will be considered before the Commission takes final action on these proposed rules. Copies of all comments received respecting these proposed rules will be available for inspection at the Commission's office in Washington, D.C.

Issued in Washington, D.C., on August 11, 1975.

For the Commission.

William T. Bagley,
Chairman, Commodity Futures Trading Commission.

[FR Doc.75-21296 Filed 8-13-75;8:45 am]

COMMODITY FUTURES TRADING COMMISSION

[17 CFR Part 180]

ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES

On July 10, 1975, the Commodity Futures Trading Commission ("Commission") published an interpretive statement in the FEDERAL REGISTER which set forth the Commission's responses to six questions posed by exchanges, boards of trade, and other interested persons, concerning the requirements of section 5a (11) of the Commodity Exchange Act ("Act"), 7 U.S.C. § 7a(11), which was added by section 209 of the Commodity Futures Trading Commission Act of 1974 ("CFTC Act"), Pub. L. No. 93-463, § 209 (October 23, 1974). *See* 40 FR 29121 (July 10, 1975). In order to assure to prompt compliance with the Commission's interpretive statement and the requirements of section 5a(11), the Commission determined to propose rules setting forth affirmative requirements for contract markets to follow in establishing arbitration or other dispute settlement procedures (herein referred to as the "prior proposed rule"). *See* 40 FR 34152 (August 14, 1975).

The Commission's announcement proposing the prior rules contained a general statement of the basis and purpose of the proposed prior rules and invited interested persons to participate in the rulemaking process by providing written submissions to the Commission. The Commission has considered all of the comments and suggestions received with respect to the proposed prior rules and prior interpretive statement and has determined to amend the prior proposed rules in the form set forth below and to seek additional comment from interested persons on the amended proposed rules prior to adoption.

The amended proposed rules have been redesignated as a new Part 180 of Title 17 of the *Code of Federal Regulations* and have been renumbered. If adopted, the amended proposed rules will not be made effective for a period of at least 90 days after adoption in order to provide an adequate opportunity for contract markets to amend and submit their own rules for approval by the Commission under section 5a(12) of the Act.

Set forth below is a discussion of specific comments received by the Commission and amendments made to the prior proposed rules as a result of those comments.

DISCUSSION

The Commission received several comments that generally criticized the "one-sidedness" or "pro-customer" nature of the Commission's proposals in expressly protecting the interests of customers, while containing few express or even comparable protections for members of contract markets. As was stated in the Commission's announcement originally proposing the prior rules, the Commission believes many of the protections implicitly apply to members. Nevertheless, the Commission, as set forth below, has determined to extend by express provision most of the protections set forth in the newly proposed rules, which are applicable to customers, to contract market members and their employees as well.

The Commission also received general comments suggesting that the Commission adopt rules only for such settlement procedures as are expressly required by section 5a(11). However, these comments overlook the breadth of the Commission's authority under section 8a of the Act, as well as significant aspects of the legislative history of the CFTC Act concerning alleged abuses in contract market arbitration proceedings. In order to prevent such alleged abuses from occurring in other circumstances, the Commission believes that it should exercise its authority to establish minimum procedural safeguards and standards for all aspects of arbitration or other settlement proceedings established by contract markets or utilized by customers.

The Commission also received one general comment criticizing the procedure of one contract market that conducts disciplinary proceedings jointly with its arbitration proceedings. The Commission believes that such a joint procedure is inappropriate and, accordingly, the Commission will not approve any such procedure under section 5a(12) of the Act.

It should be noted that the prior proposed rules gave, and the amended proposed rules give, wide latitude to the contract markets to establish their own procedures; the amended proposed rules constitute merely minimum procedural safeguards required under the Act. Within those minimums, the contract markets are free to adopt such procedures as most adequately suit their specific needs.

The Commission requests comment on whether cash market transactions effected on or subject to the rules of the contract market which provides the forum for settlement procedures should be included within §§ 180.1–180.4 of these rules (provisions relating to settlement procedures for claims under $15,000). If excluded, should the Commission go further and also exclude cash market transactions from the provisions of § 180.5 (provisions relating to settlement procedures for claims over $15,000) and/or § 180.6 (provisions with respect to member-to-member settlement procedures)?

1. Prior proposed rule § 200.1, which has been redesignated as § 180.1(b), defines the terms "customer" and "customers." The definition contained in the prior proposed rule described a "customer" or "customers" as persons engaging in a transaction through the facilities of a contract market other in the capacity of a futures commission merchant or a floor broker. As a result of comments by contract markets and others, the Commission has determined to clarify this definition by defining the nature of the "claim or grievance" that a customer or customers may submit to the procedure required by section 5a(11). This definition is designed to make clear that the terms "customer" and "customers" do not include persons having a claim or grievance solely against a person other than a member or employee of a contract market, even if the claim arose from a transaction executed through the facilities of a contract market. In that connection, the definition of the term "claim or grievance" states that a "claim or grievance" is a dispute with a contract market member or employee thereof which arises out of any transaction effected through such a member or employee and which is executed on or subject to the rules of the contract market. The prior proposed Rule has also been amended to clarify that a claim or grievance includes a claim or grievance arising from a transaction that was proposed or attempted to be effected as well as completed transactions.

Commentators also urged that the Commission exclude from the definition of "customer" or "customers" all disputes between contract market members of their employees even if such persons were acting as a customer with respect to a particular transaction. But the Commis-

sion believes that if such persons are not acting in the role of a contract market member or employee thereof, they should be entitled to the same protection as any other customer under section 5a(11) without disqualification by their role in other transactions. This is particularly true where, for example, a floor broker on one contract market executes a transaction on another contract market where the floor broker is not a member, and a claim or grievance arises from that transaction.

2. Prior proposed rule § 200.2, which has been redesignated as § 180.2, sets forth procedural requirements that must be contained in the rules of a contract market to establish the "fair and equitable procedure" required by section 5a (11) for settlement of customers' claims and grievances. Particularly, the amended proposed rule establishes procedural requirements for notice and hearing, including the right to a hearing, a right to be represented by counsel, a right to examine witnesses and other safeguards.

The prior proposed rule stated that customers must be provided an impartial arbitration panel or other decision-making body ("panel"). In that connection, the prior proposed rule stated that, while such a panel may be composed entirely of contract market members, customers must be given an election to submit the claim or grievance to a panel composed of at least a majority of persons not associated with any member of the contract market or employee thereof and not otherwise associated with the contract market ("mixed panel"). The Commission received a large number of adverse comments on this proposal. Those commentators stated, among other things, that it would be difficult and expensive to obtain qualified experts to serve on mixed panels and that, without the benefit of such experts, at little or no cost, much of the value of the contract market dispute settlement procedure would be lost. In light of those comments, the Commission has determined to amend the prior proposed rule regarding the choice by a customer of a mixed panel to require that instead of a majority, at least one third of the members of a mixed panel be persons who are not associated with any member of the contract market or employee thereof and not otherwise associated with the contract market. The Commission believes that this proposal will assure a meaningful measure of objectivity while at the same time retaining the necessary expertise of such panels. However, the Commission requests additional comment on whether mixed panels should have a greater percentage of non-associated persons.

The Commission has also determined, as a result of comments, to amend certain provisions of the prior proposed rule to clarify the timing of an election of a mixed panel. The prior proposed rule was amended to provide that contract market rules may require an election of a mixed panel to be made at the time of the submission of the claim or grievance to the contract market's procedure established pursuant to section 5a(11). As noted, concern was also expressed as to the assessment of the costs of the mixed panel. If a mixed panel is elected, the amended proposed rule provides that contract market rules may authorize a mixed panel to assess the increased costs, if any, attendant to obtaining such a mixed panel against the losing party, provided that the contingency of the assessment of such costs against the losing party are disclosed to both parties prior to the time of election.

One contract market also commented that it was not clear what type of association would disqualify a person from serving on a mixed panel, as the term "associated" is generally construed very broadly. The Commission, of course, recognizes the breadth of this term. Nevertheless, the Commission believes that such a term is necessary to prevent any direct or indirect relationships that may preclude objectivity or which may give rise to any appearance that strict objectivity or fairness is lacking. Accordingly, the Commission has retained the term in the amended proposed rule. However, the Commission does not believe that the term "associated," as used in the amended proposed rule, is so broad as to apply to such relationships as customers of contract market members, if a customer relationship with a member is limited to an account which is not a major or substantial component of the accounts of the member or the resources of the customer. Nor would association with another contract market alone preclude a person from serving on a mixed panel. The Commission also notes that contract market members or employees thereof, or non-associated persons serving on a panel (mixed or non-mixed), must not have an association with a member or employee thereof against whom the customer claim or grievance is made, or with the customer submitting the claim or grievance, that would preclude the panel member from being totally objective or which would give an appearance of lack of objectivity. The prior proposed rule has also been amended to prohibit ex parte contacts.

The Commission also received comment on the prior proposed rule which urged the Commission to extend the right to elect a mixed panel to members of a contract market or their employees. The Commission does not believe that the proposed rule as originally announced, or as amended, would preclude contract market rules from permitting such an election, provided that the contract market rules does not have the effect of discouraging customer claims or grievances from being submitted to the procedure required by section 5a(11).

The amended proposed rule also prohibits a contract market from requiring a transcript to be kept of hearings, unless agreed to by the customer or unless the customer is not assessed with the expense of the transcript. This requirement is designed to assure that customers with claims under $15,000 are not discouraged from using the settlement procedure required to be established by section 5a(11), because of possibly expensive transcript costs. One commentator suggested that transcripts should be required and that the expense should be borne by the contract markets. While the Commission would not object to a contract market assuming such costs, the Commission does not believe that this should be required, since transcripts of arbitration proceedings are often unnecessary, especially in minor cases, and may result in undue expense. Another commentator urged that this provision be extended to contract market members or employees thereof. However, the Commission believes that such an amendment is not necessary since a member or employee thereof may be authorized by a specific contract market provision to request a transcript where the customer does not make such an election. In such cases, if the contract market so desires, the member need not be assessed with the cost of a transcript.

The amended proposed rule also provides that there should be no right of appeal to any entity within the contract market which can overturn the settlement procedure decision, such as an appeal to the board of governors of the contract market; the only right of appeal being as provided under applicable law. One contract market commented that there should be a right of contract market related appeal to correct obvious cases of injustice or where there is fraud or misconduct by members of the arbitration or other panel, and in instances of material miscalculation, or misdescription or other imperfections in form. The Commission believes, however, that the rights of appeal under applicable law are adequate to provide sufficient protection against such misconduct or error.

The amended proposed rule assures the parties the right to be represented by counsel, if they so chose, in any aspect of the procedure established by a contract market pursuant to section 5a(11). One contract market commented that the right to counsel should not be applied to prohibit the staff of a contract market from communicating with a customer concerning a complaint made to the contract market. The Commission does not believe that the amended proposed rule would encompass such a prohibition. Also, in authorizing representation by counsel, the Commission does not intend that counsel be allowed to inject unnecessary formalities or objections into the proceedings.

The prior proposed rule stated that contract market rules could allow customers to waive the right of personal appearance in hearings required by the prior proposed rule through a submission on the basis of written documents. The prior proposed rule stated that such a waiver must be voluntary and could be made only after the claim or grievance arose. Several objections were made to this provision. One contract market noted that it has rules for simplified arbitration procedures in which neither party has a right personally to appear if the claim or grievance does not exceed

a specified amount.[1] That contract market stated that such provisions were adopted because out-of-state customers may not generally want to incur the expense of appearing at a hearing. The contract market also stated that the Commission's proposal was "contrary" to the procedure established by section 106 of the CFTC Act for customer reparations.

The Commission does not believe that the reparations procedure provisions of the Act control the contract market procedures required by section 5a(11) since the reparations procedure is being administered by a federal agency with full rights of review in the courts. Nevertheless, the Commission is convinced from the comments received that it would not be inappropriate for a contract market to establish a procedure whereby claims of less than $2,500 could be required to be submitted to an arbitration panel or other decisionmaking body without opportunity for either party to appear personally at a hearing, as this may reduce expense and delay in contract market settlement proceedings. The Commission has substituted that procedure for its prior proposal. Such a procedure must be administered fairly and the contract market must establish that the customer voluntarily consented to such a procedure. Also, the customer must be given the election of a mixed panel and must be given a specific warning that all procedural safeguards may not be available in the procedure. The panel hearing the claim must treat the claim in a manner conforming to proceedings where the parties are present and, as in all proceedings under the amended proposed rules, *ex parte* contacts are specifically prohibited. The Commission will review contract market rules adopting such a procedure to assure that such rules are not unfair and do not prevent customers from having access to a fair and equitable settlement procedure.

The prior proposed rule also required adequate notice of the amount and nature of any fees or costs which may be assessed against customers utilizing the procedure required by section 5a(11), and stated that any such costs must be reasonable in relation to the claim or grievance. The Commission's announcement of the prior proposed rule requested comment on the manner in which costs could be allocated and how costs for small claims or grievances could be dealt with. One contract market commented that this provision should take into consideration the complexity of the claim, rather than the dollar amount of the claim or grievance. In amending the proposed rule, the Commission has modified this provision to make clear that the limitation on excessive costs is generally to be related to both the complexity and amount of the claim or grievance. A contract market also suggested that the Commission establish standards for the allocation of costs. However, the Commission believes that this may more appropriately be left to the panel hearing the case or to a reasonable fee schedule established by a contract market.

The prior proposed rule also stated that a contract market procedure for the settlement of customer claims or grievances under section 5a(11) cannot impose restrictions on the jurisdiction or venue of any court to enforce an award rendered in such a procedure. One contract market expressed the concern that this proposal could be construed to abrogate the jurisdiction or venue of courts under applicable state laws. The Commission does not intend for the amended proposed rule to limit the scope of applicable laws. Rather, the Commission's proposal recognizes that there may be more than one applicable law and that the rules of the contract market should not attempt to restrict the application of any such law. Of course, a customer, after or at the time of the submission of a claim or grievance, could agree to a choice-of-law provision if the customer's agreement is voluntary and if the choice-of-law provision is not a condition for submission of the claim or grievance to the procedure.

As noted above, the Commission also received several comments urging that the protections for customers set forth in the prior proposed rules be extended to contract market members and employees. After considering the comments received, the Commission believes that certain protections should be made explicit for all participants in a proceeding under section 5a(11). Accordingly, the proposed rule has been amended to extend explicitly protections to other participants, including the right to counsel, adequate notice and opportunity for prompt hearing and adequate opportunity to prepare for hearings. Protections for contract market members or employees thereof should not, however, be applied in a manner that will unnecessarily or unfairly impair the interests of customers.

Finally, the Commission substituted the word "examine" for "cross-examine" in granting parties the right to question all witnesses appearing at the hearing. This is to reflect only that technical rules of evidence or procedure do not apply; however, this amendment does not limit the right of a party to question a witness.

3. Prior proposed rule § 200.3, which has been amended and redesignated as § 180.3, states that the use by a customer of the procedure established by a contract market pursuant to section 5a(11) for settlement of customers' claims and grievances against any member or employee thereof, shall be voluntary. The prior proposed rule provided that a procedure for settlement of customer claims or grievances established by a contract market pursuant to section 5a(11) must prohibit any agreement or understanding pursuant to which customers agree to submit a claim or grievance for settlement prior to the time when the claim or grievance arose.

The Commission received comments criticizing this provision. Particularly, one commentator stated that the Commission is not justified in finding that a customer voluntarily executing a standard customer's agreement is not aware of the nature and consequences of such an agreement. However, the Commission is convinced that this provision is necessary and appropriate in light of the affirmative requirement in section 5a(11) that the use of the procedure established under that section "by a customer shall be voluntary." The Commission does not believe that a waiver of this right should be allowed through customer account agreements signed at the time an account is opened. Such agreements may be contracts of adhesion and the customer's waiver may not be an informed decision, since the claim or grievance will not generally arise until some time in the future.

The prior proposed rule also prohibited futures commission merchants, floor brokers, associated persons or other persons registered with the Commission from entering into any agreement or understanding with a customer in which the customer agrees to submit claims or grievances pertaining to any matters or transactions subject to the jurisdiction of the Commission to any settlement procedure prior to the time the claim or grievance arose. The Commission received several comments strongly criticizing this provision. The principal criticisms expressed in those comments were that the Commission had incorrectly relied on an unrelated Supreme Court case, *Wilko v. Swan*, 346 U.S. 427 (1953), an action under the federal securities laws; that the Commission is not empowered to adopt such a requirement under section 5a(11); that the Federal Arbitration Act, 9 U.S.C. Sections 1–14 (1970), precludes such a requirement; and that such a provision would interfere with existing contractual rights. The Commission's action, in the first instance, was not premised on *Wilko v. Swan*. The second of these objections overlooks the fact that the Commission's prior proposed rules were not adopted solely pursuant to section 5a(11). The Commission's announcement stated that those prior rules were being proposed pursuant to section 8a of the Commodity Exchange Act, as amended, 7 U.S.C. 12a, as well as under section 5a(11).

Section 8a of the Commodity Exchange Act, as amended, states in part that the Commission is authorized to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions of the Act or to accomplish any of the purposes of the Act. Section 8a also grants the Commission broad authority over all aspects of customer transactions. As already noted, one factor leading to passage of the CFTC Act was allegations made in court cases and newspaper

[1] The arbitration committee of the contract market may allow personal appearances where the committee deems it necessary. Where a personal appearance is not permitted the arbitration committee would base its decision upon written documents and would accept affidavits and depositions on matters relating to the settlement of the claim or grievance.

articles that the arbitration procedures of contracts markets had been unfairly applied. The Commission believes that the procedural protections contained in the amended proposed rules will prevent the possibility of abuses such as those alleged in the congressional hearings. The voluntary nature of procedures established by contract markets is a central part of this protection. A contract of adhesion, or an uninformed waiver of rights, is not a voluntary agreement, as customers may not be fully cognizant of the effects of an agreement to arbitrate until the claim or grievance arises. The amended proposed rule, therefore, provides that the parties' agreement to submit the claim or grievance to the procedure must have been made after the claim or grievance arose.

In light of the legislative history of the CFTC Act, the Commission believes that policies which may be reflected in the Federal Arbitration Act do not restrict the Commission from regulating agreements that concern transactions on a contract market. Rather, the Commission's authority is sufficiently broad to assure that customers are not precluded from utilizing, or are not forced to utilize, a procedure for settlement of claims or grievances established pursuant to section 5a(11) by agreements with registered persons entered into prior to the time when a claim or grievance arose. Additionally, since the procedure is not compulsory, the parties may choose to present the claim or grievance to any other forum for settlement, such as the American Arbitration Association, any time after the claim or grievance arises.

The Commission is amending the prior proposed rule to make clear that the proposed rule does not apply to claims or grievances which may arise before adoption of the proposed rule. However, existing contracts would be null and void one year after the effective date of the proposed rule, except as to claims and grievances arising before and during the one year period. The amended proposed rule would also expressly prohibit new agreements with such provisions after the effective date of the proposed rule.

The prior proposed rule authorizes a settlement procedure established by a contract market under section 5a(11) to require customers utilizing such a procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure before such award is rendered. The prior proposed rule has been amended to make clear that all parties submitting to the procedure could be bound by the award. Any award so rendered shall be enforceable in accordance with applicable law.

One commentator urged that awards rendered in procedures permitted by the prior proposed rules be limited to monetary amounts. While the Commission believes that awards normally will be monetary in nature only and that a claim or grievance should be primarily related to monetary damages, there may be limited instances where a non-monetary award is appropriate in connection with a monetary award. For example, there may be a need for tangential relief flowing from a monetary award, such as requiring the transfer or liquidation of an account. However, the Commission believes that any such non-monetary awards should be limited to those matters involving monetary amounts and does not believe that a contract market procedure established pursuant to section 5a(11) should provide for any advisory opinions.

The prior proposed rule also states that the procedure for the settlement of customers' claims and grievances established by a contract market pursuant to section 5a(11) of the Act shall not establish any unreasonably short limitation period foreclosing submission of customers' claims or grievances to the procedure. In proposing the prior rule, the Commission stated that a limitation foreclosing customers' claims or grievances from submission to the procedure unless submitted within 90 days after the claim or grievance arose, is not, in the Commission's view, reasonable. On the other hand, the Commission stated that a limitation period of two years from the time the claim or grievance arose would appear reasonable.

One contract market and other commentators said that a limitation period of two years was too long and urged that the Commission endorse a shorter period of time. However, the Commission's earlier statement does not preclude a limitation period shorter than two years. Rather, the Commission believes that the contract markets should, in the first instance, determine whether a shorter limitation period is appropriate. The Commission will review limitation provisions pursuant to section 5a(12) of the Act and will determine at that time whether shorter limitation periods are justified. Accordingly, the Commission does not believe it is necessary to amend its earlier statement at this time.

One contract market also suggested that the Commission extend the prohibition against unreasonably short limitation periods to counterclaims of members. The Commission believes that such a provision is appropriate and accordingly has amended the prior proposed rule to effect this change.

4. Prior proposed rule § 200.4, which has been redesignated as § 180.4, sets forth the circumstances under which a counterclaim by a member of a contract market or employee thereof may be made against a customer under a settlement procedure established pursuant to section 5a(11). The prior proposed rule permitted a contract market member or employee thereof to make a counterclaim to a customer's claim or grievance where the counterclaim arose out of the same transaction or occurrence that is the subject of the customer's claim or grievance and does not require for adjudication the presence of third parties over whom the contract market does not have jurisdiction. Also, such counterclaims may not be for an amount in excess of $15,000. The Commission's announcement of this proposal requested comment on whether the consent of customers should be required for counterclaims that do not arise out of the same transaction or occurrence as the customers' claim or grievance; the prior proposed rule permitted such other counterclaims only if the customer agrees to the submission of the counterclaim after the counterclaim has arisen, and if the counterclaim is less than $15,000.

The Commission received both favorable and critical comments on this proposal. Most of those comments urged that the Commission broaden the prior proposed rule by expanding the concept of compulsory counterclaims or grievances, including allowing counterclaims in excess of $15,000.[3] After carefully reviewing these comments and the requirements of section 5a(11), the Commission has concluded that on balance it should not amend the prior proposed rule at this time. Section 5a(11) was adopted by the Congress as a means to provide customers with a procedure for settling disputes that would not result in a compulsory payment except as agreed upon between the parties. The Commission is concerned that this aspect of section 5a(11) will be impaired if counterclaims are allowed which do not arise out of the transaction or occurrence that is the subject of the customer's claim or grievance and which the customer does not agree to submit to the procedure. This is especially true since the amended proposed rule allows contract markets to provide for mandatory awards after submission of a dispute to the procedure. Thus, under the amended proposed rule a customer is submitting a claim or grievance for adjudication and can expect to be subject to a counterclaim arising from the same transaction or occurrence. The customer need not, however, necessarily expect that an unrelated counterclaim will be made. Allowing other counterclaims without the explicit permission of customers could discourage use of the procedure required by section 5a(11). In addition, section 5a(11) by its terms precludes a procedure whereby any claim in excess of $15,000 is adjudicated, whether by direct claim or by counterclaim; however, such claims or counterclaims could be submitted to a separate contract market settlement procedure established pursuant to proposed rule § 180.5, discussed below.

The Commission was also asked to clarify the types of counterclaims that would be subject to the provisions of the

---

[3] For example, one contract market urged that the Commission amend the description of the counterclaims that may be made by a member or employee thereof without the permission of the customer, to permit counterclaims arising out of a "transaction or occurrence on the contract market involving the same account or relationship between the two parties as that upon which the customer's claim or grievance is based."

prior proposed rule. However, the Commission believes that the standards set forth in proposed rule §180.4 are sufficiently clear to determine what counterclaims are covered. More specific standards would not be exhaustive and may create confusion in unusual cases. The Commission, however, construes the term counterclaim to include setoffs and other such claims.

5. Prior proposed rule § 200.5, which has been redesignated as § 180.5, permits a contract market to establish a procedure for settlement of customers' claims and grievances which are not covered by section 5a(11) (*e.g.*, claims for amounts involving more than $15,000). Such a procedure is required by the amended proposed rule to be independent of and may not interfere with or delay the resolution of customers' claims or grievances submitted under the procedure required by section 5a(11). Also, the amended proposed rule states that the procedure must be fair, equitbale, and voluntary.

The prior proposed rule provided that where a customer claim or grievance—which includes counterclaims of a contract market member or employee—exceeded $15,000, the customer must be warned in writing in advance of submission to the procedure that all the procedural safeguards applicable in a court of law may not be available. The prior proposed rule also provided that the contract market must be able to establish that, notwithstanding such formal warning, the customer voluntarily submitted the dispute to theprocedure. Commentators noted, however, that such warning would be difficult to prepare and may not be comprehensible to most customers. Accordingly, the Commission has amended this provision to require only a general warning that all safeguards available in a court of law may not be available in the procedure and an acknowledgement of such warning. The required warning is set forth in the text of the amended proposed rule.

The Commission received comments which suggested that the Commission did not have authority to authorize a contract market to establish procedures for the settlement of claims or grievances in matters not covered by section 5a(11); some of those comments made reference to leg. lative history of the CFTC Act which indicates that members of Congress were concerned that claims larger than $15,000 could delay or impair settlement of smaller claims. However, the Commission's amended proposed rule does not require the establishment of such a procedure by a contract market—the establishment of any such procedure being entirely within the discretion of the contract market. Furthermore, the Commission's amended proposed rule states that a settlement procedure for claims in excess of $15,000 shall be independent of and shall not interfere with, or delay the resolution of, customers' claims or grievances submitted under the procedure required by section 5a(11). The Commission believes that this requirement will conform to the congressional purpose behind the $15,000 limitation contained in section 5a(11) and will allow contract markets desiring arbitration procedures adequate time to process larger claims—without delaying settlement of scetion 5a(11) claims—to do so.

The Commission also received comments with respect to the prior proposed rule which contended that the Commission should not require separate procedures for claims submitted pursuant to section 5a(11) and other claims. However, the Commission believes that such separate procedures are necessary in order to meet the congressional purpose of preventing claims submitted pursuant to section 5a(11) from being delayed. Accordingly, the Commission has not amended the prior proposed rule in that regard.

6. Prior proposed rule § 200.6, which has been amended and redesigned as § 180.6, permits a contract market to establish a dispute resolution procedure for claims in which a customer is not involved (*e.g.*, the resolution of a dispute involving only futures commission merchants or floor brokers who are members of a contract market). The amended proposed rule provides that this procedure must be independent of and must not interfere with or delay the resolution of customers' claims or grievances submitted under the procedure required by section 5a(11). Also, the procedure must establish procedural safeguards which include, at a minimum, fair and equitable procedures as defined by proposed rules § 180.2 and § 180.3 of this Part, except that the election of panel members contained in proposed rule § 180.2(a) need not be required.

The prior proposed rule originally provided that submission of such claims to such a procedure must be accompanied by a written warning, in advance of the submission, that all formal legal safeguards would be unavailable. The prior proposed rule also stated that after receiving such warning, the parties may voluntarily agree to go forward. Several contract markets objected to this aspect of the prior proposed rule, as they believed that arbitration between members should be mandatory. After considering these comments the Commission has determined that contract markets should be permitted to establish mandatory arbitration or other settlement procedures for claims between members of the contract market. This will assure that member disputes are quickly and efficiently resolved. The Commission believes prompt and efficient resolution of members' disputes is important for the reason, among others, that this will offer greater assurance of the financial integrity of the clearing corporations of contract markets which act as guarantors of all trades. Accordingly, the prior proposed rule was amended to permit the contract markets to establish a compulsory arbitration or other settlement procedure for claims or grievances which do not involve customers. The previously proposed warning requirement was also deleted. But, as noted above, such compulsory arbitration must always be fair and equitable.

In consideration of the foregoing, the Commission hereby proposes to amend Chapter I of Title 17 of the *Code of Federal Regulations* by adding a new Part 180, as follows:

PART 180—ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES

Sec.

180.1 Definitions.
180.2 Fair and Equitable Procedure.
180.3 Voluntary Procedure and Compulsory Payments.
180.4 Counterclaims.
180.5 Other Customer Claims and Grievances.
180.6 Member-to-Member Settlement Procedures.

AUTHORITY: Secs. 5a(11) and 8a, Commodity Exchange Act, as amended, ("Act") 7 U.S.C. § 7a(11), 12a.

§ 180.1 Definitions.

(a) The term "claim or grievance" as used in this Part shall mean any dispute which arises out of any transaction on or subject to the rules of the particular contract market which is the forum for the settlement procedure, executed by or effected through, or proposed to be, or attempted to be executed by, or effected through, a member of that contract market or employee thereof, which claim or grievance does not require for adjudication the presence of essential witnesses or third parties over whom the contract market does not have jurisdiction and who are not otherwise available.

(b) The terms "customer" and "customers" as used in this Part shall mean any person with a claim or grievance against a member of the particular contract market which is the forum for the settlement procedure, or employee thereof. The terms "customer" and "customers" do not include a futures commission merchant or floor broker, as defined in the Act, unless such persons were acting in a capacity other than that of a floor broker or futures commission merchant in connection with a claim or grievance they seek to submit to the settlement procedure of the contract market.

§ 180.2 Fair and equitable procedure.

Within ninety days of the effective date of this Part, every contract market shall, in conformance with the Act, adopt rules which provide for a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof which arose on or after April 21, 1975 and was not submitted for arbitration prior to the effective date of this Part. The procedure shall not be applicable to any claim or grievance in excess of $15,000. The rules of the contract market shall include at least the following as *minimum* requirements for a fair and equitable procedure:

(a) The procedure shall be objective and impartial. Customers must be pro-

vided with the choice of a panel or other decision-making body having at least one-third of the persons serving thereon who are not members or associated with any member of the contract market, or employee thereof, and who are not otherwise associated with the contract market. The rules of a contract market may, with proper notice, require the customer to request such a panel or other such decision-making body at the time of submission of the claim or grievance to the procedure, and, if such an election is made, to notify the customer at such time that the panel or other such decision-making body may, in its discretion, assess the losing party with the increased costs, if any, attendant to having such a panel or decision-making body. *Ex parte* contacts by any of the parties with members of any panel shall not be permitted.

(b) The procedure shall grant each of the parties the right, if desired, to be represented by counsel, at his own expense, in any aspect of the procedure.

(c) The procedure shall provide for the prompt settlement of claims or grievances and counterclaims, if any (permitted by § 180.4 of this Part). Unnecessary or unreasonable delay by any of the parties shall not be permitted.

(d) The procedure shall require adequate notice to the parties and opportunity for a prompt hearing as follows:

(1) Each of the parties shall be entitled personally to appear at such hearing, unless the contract market shall have adopted a procedure for the written submission of claims or grievances (and any counterclaims applicable thereto) which are in the aggregate under $2,500. If the claim or grievance (and any counterclaim applicable thereto) is in the aggregate under $2,500, then provision may be made for the claim or grievance of a customer to be resolved without a hearing through a submission on the basis of written documents: *Provided*, Customers are given, and acknowledge receipt of, the following warning: "All procedural safeguards available in other arbitration procedures conducted under the auspices of [insert name of contract market] are not available in this procedure which provides for written submissions only. This procedure is voluntary and you need not submit your claim or grievance to this procedure."

(2) The formal rules of evidence need not apply at the hearing. Nevertheless, the procedures established may not be so informal as to deny due process. Each party must be given adequate opportunity to prepare and present all relevant facts in support of the claims and grievances, defenses, or counterclaims (permitted by § 180.4 of this Part), and to present rebuttal evidence to such claims or grievances, defenses or counterclaims made by the other parties.

(3) Each party shall be entitled to examine other parties and any witnesses appearing at the hearing and to examine all relevant documents presented in connection with a claim or grievance, defense or a counterclaim (permitted by § 180.4 of this Part).

(4) A transcript shall not be required, unless the customer making the claim or grievance so agrees or unless the customer is not assessed with the cost of the transcript.

(e) The procedure shall provide adequate notice to the parties in advance of a submission of a claim or grievance, or counterclaim (permitted by § 180.4 of this Part), of the amount of any fees or costs and the nature of any costs which may be assessed against customers utilizing the procedure. Fees or costs shall be reasonable, particularly in relation to the complexity and amount of the claim or grievance or counterclaim presented. Costs may be apportioned among the parties or may be assessed against the losing party as the panel or other decision-making body in its discretion sees fit.

(f) The procedure shall provide that the settlement award shall be rendered promptly in writing and be final. There shall be no right of appeal to any entity within the contract market which can overturn the settlement procedure decision; the only right of appeal being as provided under applicable law.

(g) The procedure shall not impose any restrictions on the jurisdiction or venue of any court to enforce an award so rendered.

§ 180.3 Voluntary procedure and compulsory payments.

(a) The use by customers of the procedure established by a contract market pursuant to the Act shall be voluntary. In that connection the procedure established shall prohibit any agreement or understanding pursuant to which customers agree to submit claims or grievances for settlement under the procedure so established prior to the time when the claim or grievance arose.

(b) No futures commission merchant, floor broker, associated person or any other person registered with the Commission under the Act shall enter into any agreement or understanding with a customer in which the customer agrees to submit a claim or grievance pertaining to any matter or transaction subject to the jurisdiction of the Commission to any settlement procedure prior to the time such claim or grievance arose: *Provided*, however, That this subparagraph shall not apply to claims or grievances arising out of transactions occurring prior to the date of the adoption of this Part and for a period of one year thereafter if and only if such transactions were subject to agreements actually entered into prior to the date of the adoption of this Part.

(c) The procedure established by a contract market pursuant to section 5a (11) of the Act may require parties utilizing such procedure to agree under applicable state law, submission agreement or otherwise to be bound by an award rendered in the procedure, so long as the agreement to submit the claim or grievance to the procedure was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(d) The procedure established by a contract market pursuant to the Act shall not establish any unreasonably short limitation period foreclosing submission of customers' claims or grievances or counterclaims of contract market members or employees (permitted by § 180.4 of this Part).

§ 180.4 Counterclaims.

A procedure established by a contract market under the Act for the settlement of customers' claims or grievances against a member or employee thereof may permit the submission of a counterclaim in the procedure by a person against whom a claim or grievance is brought. The contract market may permit such a counterclaim where the counterclaim arises out of the transaction or occurrence that is the subject of the customer's claim or grievance and does not require for adjudication the presence of essential witnesses, parties or third parties over whom the contract market does not have jurisdiction. Such a counterclaim may not be for an amount in excess of $15,000. Other counterclaims are permissible only if the customer agrees to the submission after the counterclaim has arisen, and if the aggregate monetary value of the counterclaim is capable of calculation and is not in excess of $15,000.

§ 180.5 Other customer claims and grievances or disputes.

A contract market may establish a procedure for settlement of customers' claims and grievances or disputes against any member or employee thereof, which are not covered by §§ 180.1 through 180.4 of this Part. The procedure shall be independent of, and shall not interfere with or delay the resolution of, customers' claims or grievances submitted for resolution under the procedure of a contract market established pursuant to the Act. The customer must be given the following warning in writing, in advance of the submission of the claim or grievance or dispute to the procedure: "All formal legal safeguards provided in a court of law may not be available in this procedure. This procedure is voluntary and you need not submit to this procedure." Receipt of the warning shall be acknowledged in writing by the customer prior to or at the time of the submission of the claim or grievance or dispute to the procedure. If, after the receipt and acknowledgement of such warning, the customer voluntarily agrees to submit the claim or grievance or dispute to the procedure, the procedure may go forward; but the procedure must be shown to be voluntary, and must be fair and equitable as defined by § 180.2 and § 180.3 of this Part.

§ 180.6 Member-to-member settlement procedures.

A contract market may establish a procedure for compulsory settlement of claims and grievances or disputes which do not involve customers. If adopted, the procedure shall be independent of, and shall not interfere with or delay the reso-

lution of, customers' claims or grievances submitted for resolution under the procedure established pursant to the Act. Such a procedure shall provide procedural safeguards which must include, at a minimum, fair and equitable procedures conforming to those set forth in § 180.2 of this Part, except that the election of panel members contained in § 180.2(a) of this Part need not be required.

• • • • •

Interested persons may participate in this proposed rulemaking proceeding by submitting comments in written form to the Commodity Futures Trading Commission, 1120 Connecticut Avenue NW., Washington, D.C. 20036: Attention: CCU. All comments received on or before December 22, 1975, will be considered before the Commission takes final action on the proposal. Copies of all comments received respecting the proposal will be available for inspection at the Commission's office in Washington, D.C.

Issued in Washington, D.C. on November 18, 1975.

For the Commission.

WILLIAM T. BAGLEY,
Chairman, Commodity Futures Trading Commission.

[FR Doc.75-31628 Filed 11-21-75;8:45 am]

COMMODITY FUTURES TRADING COMMISSION

ARBITRATION OF OTHER DISPUTE SETTLEMENTS PROCEDURES

Notice of Public Hearing

Commencing at 10:00 a.m. on Friday, March 5, 1976, the Commodity Futures Trading Commission will receive oral and written testimony from interested persons concerning the Commission's revised proposed rules on arbitration or other dispute settlement procedures. Interested persons may participate in this hearing, which will be held at the Arlington Room of the Madison Hotel, 15th and M Streets, N.W., Washington, D.C.

Background.—On July 10, 1975, the Commodity Futures Trading Commission published an interpretative statement in the FEDERAL REGISTER (40 F.R. 29121) which set forth the Commission's responses to six questions raised by boards of trade and other interested persons, concerning the requirements of section 5a(11) of the Commodity Exchange Act, as amended, 7 U.S.C. § 7a(11).[1] Thereafter, the Commission proposed rules setting forth requirements for contract markets and participants in arbitration or other dispute settlement pocedures. See 40 FR 34152 (August 14, 1975).[2]

After reviewing comments received on the proposed rules, the Commission revised its proposals and sought additional comments from interested persons. *See* 40 FR 54430 (November 24, 1975). The Commission has received additional comments on the revised proposed rules and has received requests for an opportunity for an oral hearing. The Commission has determined to grant such as opportunity.

At the oral hearing, the Commission requests comments particularly on proposed rules § 180.01, concerning the definition of "customer;" § 180.3, which would, among other things, prohibit clauses in contracts between futures commission merchants and customers that contain mandatory arbitration clauses; § 180.4, which concerns counterclaims made in a contract market arbitration or other dispute settlement procedures; and on whether the proposed rules should apply to cash market transactions. See 40 FR 54430 (November 24, 1975). The Commission further requests comments on the interrelationship of contract market procedures established pursuant to section 5a(11) and Commission reparation proceedings under section 14 of the Commodity Exchange Act, 7 U.S.C. § 18.[3] The Commission will also accept comments on other areas of the proposed rules that interested persons may wish to comment upon.

Persons interested in participating in the Commission's hearing should contact Ms. Jane Stuckey, Commodity Futures Trading Commission, 1120 Connecticut Avenue, N.W., Washington, D.C. 20036, (202) 254–6314, before February 27, 1976. In addition, persons wishing to appear at the Commission's hearing should forward an outline of their proposed testimony to Ms. Stuckey by March 2, 1976. Oral presentations will be limited to 15 minutes. The Commission or its staff may question commentators at the conclusion of their prepared testimony.

Issued in Washington, D.C., on February 5, 1976.

For the Commission.

WILLIAM T. BAGLEY,
Chairman, Commodity Futures Trading Commission

[FR Doc.76-3975 Filed 2-10-76;8:45 am]

[1] Section 5a(11) states that each contract market shall . . . provide a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof: Provided, That (i) the use of such procedure by a customer shall be voluntary, (ii) the procedure shall not be applicable to any claim in excess of $15,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties, and (iv) the term "customer" as used in this subsection shall not include a futures commission merchant or a floor broker. . . .

[2] The Commission's rules were proposed pursuant to §§ 5a(11) and 8a of the Commodity Exchange Act, as amended, 7 U.S.C. § 7a(11) and 12a.

[3] *See* 41 FR 3994 (January 27, 1976).

COMMODITY FUTURES TRADING COMMISSION

[17 CFR Part 180]

ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES

Notice of Proposed Rulemaking

On November 24, 1975, the Commodity Futures Trading Commission ("Commission") proposed rules governing contract market arbitration or other dispute settlement procedures, which were published at 40 FR 54430. The Commission has adopted rules §§ 180.1, 180.2, 180.4, 180.5 and 180.6 in substantially the same form as previously proposed. See 41 FR 27520 (same date as this notice). However, the Commission has determined to amend previously proposed § 180.3 in the form set forth below and to seek additional comment from interested persons on the amended proposed rule prior to adoption.

The Commission's previously proposed rule § 180.3 provided that use of the arbitration or other dispute settlement procedures for customers established by contract markets must be voluntary. That rule also stated that contract market rules governing such procedures must prohibit any agreement or understanding pursuant to which customers agreed to submit claims or grievances for settlement under the procedure prior to the time the claim or grievance arose. It also prohibited persons registered with the Commission from entering into any agreement or understanding with the customer in which the customer agreed to submit a claim or grievance, pertaining to any transaction subect to the jurisdiction of the Commission, to an arbitration or other dispute settlement procedure prior to the time such claim or grievance arose. However, these prohibitions did not apply to claims or grievances arising out of transactions occurring prior to the date of adoption of the previously proposed rule and for a period of one year thereafter—provided that such transactions were subject to agreements entered into before the adoption of the rule.

The Commission received favorable comments on this proposal from at least one customer-oriented representative, but the Commission also received several adverse comments on previously proposed rule § 180.3, most of which were made by futures commission merchants. Commentators supporting both of these viewpoints presented legal and policy-oriented arguments in favor of their positions; some of these arguments are discussed below and others are discussed in the Commission's prior explanation of its proposed rules in the FEDERAL REGISTER. See 40 FR 54430, 54432-34 (November 24, 1975). The Commission also received comments from a representative of the American Arbitration Association, who expressed concern that the Commission's proposed rule may have an adverse impact upon the efficacy of arbitration and may tend to discourage persons from utilizing the arbitration process.

The Commission has weighed carefully the comments by futures commission merchants, customer representatives and the American Arbitration Association. And, the Commission has taken cognizance of the utility and need for arbitration, which provides a mechanism for quick and less costly resolution of disputes.[1]

The Commission also recognizes that, unless there is binding arbitration, futures commission merchants and other registered persons will have no recourse except to the courts for settling disputes with customers. This will increase the time in which a dispute may be unresolved and entail greater expense that will ultimately be borne by customers as a cost of doing business. For those reasons, the Commission believes that binding arbitration agreements are to be encouraged. Nevertheless, the Commission believes that it must establish requirements that will assure customers of a futures commission merchant or other registered person do not unknowingly or involuntarily waive rights and remedies available under the Commodity Exchange Act.

Agreements presently utilized by futures commission merchants may discourage customers from using the Commission's reparation procedures under section 14 of the Act, which was intended by Congress to give customers an alternative forum to obtain relief from registered persons who have violated the Commodity Exchange Act or rules thereunder.[2] In this connection, a House report on the legislation which became sections 5a(11) and 14 of the Act stated that:

> This section [Section 14] establishes a formal complaint procedure before the Commission for the adjudication of grievances which result from violations of the Act. It is primarily intended as a forum for aggrieved customers [certain] persons registered under the Act * * *. *The procedure is also intended as a separate remedy designed to supplement the informal "settlement procedures" contemplated of the contract markets* * * which are required under other sections of the legislation (H.R. 13113, Sections 209 * * *). The Committee expects the Commission to publish regulations, commensurate with these related provisions of the Act, to implement and coordinate these * * * types of grievance proceedings and their utilization and availability for resolution of disputes.[3]

Further, unless there is an informed consent, customers may be unwittingly deprived of a private right of action in the federal courts for violation of the Commodity Exchange Act or rules thereunder.[4]

The Commission has determined that it should be guided by the statutory language of section 5a(11), which requires contract markets to establish arbitration or other dispute settlement procedures that are "voluntary." In this connection, futures commission merchants testified before the Commission in its oral hearing on March 5, 1976, that those firms would refuse to deal with persons who declined to sign binding arbitration agreements contained in customer agreement forms. This precludes a "voluntary" act by customers, since they would be effectively frozen out of the market unless they signed mandatory predispute arbitration agreements. Also, the Commission has observed that the customer agreement forms of most futures commission merchants provide for arbitration of customer claims or grievances in a forum other than the contract market where the claim or grievance arises. The Commission believes, in light of the widespread use of these forms in industry, that such agreements could discourage and may effectively preclude utilization of arbitration or other dispute settlement procedures mandated by section 5a(11) or permitted by the Commission's rules. This frustrates the operation of section 5a(11) in that customers are not being given access to contract market arbitration or other dispute settlement procedures that are "voluntary."

After careful review of the comments it has received, the Commission has determined to amend previously proposed rule § 180.3 in order to assure the efficacy

---

[1] The Chief Justice of the United States Supreme Court has only recently stressed the value of arbitration in resolving disputes. See, Speech by Warren Burger, Agenda for 2000 A.D.—Need for Systematic Anticipation, given on April 7, 1976, in St. Paul, Minnesota, before the National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice.

[2] 7 U.S.C. § 18 (Supp. IV, 1974). Section 14 of the Act allows any person complaining of violations of the Act by a person registered under the Act to apply to the Commission for reparation of a specific monetary amount. The Commission has established rules of procedure for complaints under section 14, the manner in which hearings are conducted and, where appropriate, procedures for setting the amount of reparation due to the injured party. See 41 F.R. 3994 (January 27, 1976). Section 14 became effective on January 23, 1976. After that date, the Commission can hear claims for reparations arising after January 23, 1975, in that section 14 applies to claims which arose within one year immediately prior to its effective date; thereafter the limitation period becomes a two-year period from the date of the violative transaction. See Section 106 of the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463 (October 23, 1974), as amended, Pub. L. No. 94-16 (April 16, 1975).

[3] H.R. Rep. No. 93-975, 93d Cong., 2d Sess. 22 (1974) (emphasis supplied). The report also stated (*id* at 23) that contract market settlement procedures would be "complementing the Commission's procedures" and that:

> It is the intent of the Committee that those complaints which can be resolved informally and settled without a formal proceeding through the mechanism contemplated of the contract market or * * * futures association should be encouraged to be resolved in such manner.

[4] See generally, e.g., Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967). The Commission does not support the proposition that a binding arbitration agreement will constitute a waiver of a private right of action where the agreement was not entered into voluntarily or where the customer unknowingly waived this right.

of arbitration or other dispute settlement procedures as well as to meet the requirements of section 5a(11), which require such procedures to be available and to be voluntary. Because of the controversal nature of proposed § 180.3, the Commission has decided to seek additional public comment. As amended, proposed § 180.3 would prohibit agreements between customers and futures commission merchants or other registered persons that require submission of claims or grievances to a binding arbitration procedure prior to the time the claim or grievance arises, unless the agreement meets certain prescribed conditions. For example, the agreement would be required to be in writing and the customer would have to be given specified written warnings in large bold-faced type as to the effect of the agreement. Also, such agreements could not be used to prevent customers from seeking reparations under section 14 of the Act, 7 U.S.C. 18, except as prescribed in the rule.

Proposed rule § 180.3, as amended, thus provides that even where there is a binding arbitration agreement, the customer may elect to seek reparations instead. This option may be exercised by the customer before requesting arbitration or within thirty days after the futures commission merchant or other registered person seeks to arbitrate under the otherwise binding arbitration agreement. In the event the customer seeks a reparation proceeding but the Commission declines to accept the claim under the procedure, the claim may thereafter be submitted to the arbitration procedure under the agreement.[2] Also, aspects of a claim or grievance that are not cognizable in the reparations procedure may be submitted to arbitration (*i.e.*, claims or grievances that do not involve violations of the Act or rules thereunder). If the customer elects the arbitration proceeding, he will thereafter be foreclosed from seeking reparations for the claim or grievance submitted in the proceeding. Similarly, in instances where a reparation proceeding is concluded, there will be a *res judicata* effect as to the matter considered in the reparation proceeding. As was noted in the House report on the legislation which became section 14 of the Act:

> A customer reparation proceeding before the Commission will be authorized • • • for handling customer complaints which arise from violations of the Act, particularly those which result in monetary damages to the customer. The Commission will have original jurisdiction to consider all such complaints which have not been resolved through the informal settlement procedure required of the contract markets [under section 5a(11)] • • • •[3]

If a binding arbitration agreement is utilized prior to the occurrence of the claim or grievance, proposed rule § 180.3, as amended, requires customers to be given adequate warning of their rights. Specifically, such agreements must contain the following warning in large boldface type:

> WHILE THE COMMODITY FUTURES TRADING COMMISSION (CFTC) ENCOURAGES THE SETTLEMENT OF DISPUTES BY ARBITRATION, IT REQUIRES THAT YOUR CONSENT TO SUCH AN AGREEMENT BE VOLUNTARY. YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [name of fcm]. See 17 C.F.R. §§180.1–180.6.
>
> BY SIGNING THIS AGREEMENT, YOU MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW, BUT YOU ARE NOT WAIVING YOUR RIGHT TO ELECT LATER TO PROCEED PURSUANT TO SECTION 14 OF THE COMMODITY EXCHANGE ACT TO SEEK DAMAGES SUSTAINED AS A RESULT OF A VIOLATION OF THE ACT. IN THE EVENT A DISPUTE ARISES AND YOU ARE NOTIFIED THAT [name of fcm] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION, IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND YOU PREFER TO REQUEST A SECTION 14 "REPARATIONS" PROCEEDING BEFORE THE CFTC, YOU WILL STILL HAVE 30 DAYS IN WHICH TO MAKE THAT ELECTION.

Proposed rule § 180.3 requires the arbitration clause in these agreements to be separately endorsed by the customer. If the customer declines to sign this agreement, the futures commission merchant may not use that refusal alone as a ground for rejecting that person as a customer of that firm.

If an arbitration agreement with a customer specifies a forum for settlement other than the arbitration or other dispute settlement procedure established pursuant to section 5a(11) of the Act and Commission rules (e.g., American Arbitration Association or New York Stock Exchange), the proceedings in such a forum must comply with the requirements set forth in Commission rule §180.5. This requirement is designed to assure that customers are given adequate procedural and other protections.

In brief, an agreement for binding arbitration in advance of a claim or grievance could be entered into as follows: A prospective customer of a futures commission merchant would be asked by the futures commission merchant to sign a customer agreement and to separately endorse that part of the agreement containing the binding arbitration agreement and warning. If the prospective customer refuses to do so, such refusal alone could not be used as a basis for declining to deal with the customer. If the customer endorses the clause or clauses and a claim or grievance subsequently arises, the customer may seek to submit the claim or grievance to the reparation procedure under section 14 of the Act at any time prior to submitting the claim or grievance to the arbitration or other dispute settlement procedure specified in the agreement. On the other hand, if the futures commission merchant or other registered person who is a party to the agreement seeks to submit a claim or grievance to the arbitration or other dispute settlement procedure specified in the agreement, the customer must be notified in writing of that intent at least thirty days prior to the submission of the claim or grievance to the procedure. The same notice must also state that the customer may submit the claim or grievance to the reparation procedure available under section 14 of the Act, provided that section is applicable. If a claim or grievance is not submitted to the reparation procedure within thirty days after notice is received by the customer, the arbitration or other dispute settlement procedure may be utilized by the registered person. If the Commission does not commence a reparation proceeding as requested by a customer, or to the extent the claim or grievance is not subject to the reparation procedure, the claim or grievance may be submitted to the arbitration or other dispute settlement procedure under the agreement.

The Commission has also determined to revise the effective date of amended proposed rule § 180.3. As noted, previously proposed rule § 180.3 contained a provision which delayed its effective date for certain existing arbitration agreements. After further consideration, however, the Commission is concerned that this provision may be inconsistent with the rights of persons under the Act who are affected by such agreements. The Commission has determined that amended proposed rule § 180.3, if adopted, would be effective 60 days after notice of adoption is published.

On the effective date, all compulsory arbitration agreements which do not comply with the amended proposed rule § 108.3 will be null and void, including

[2] Section 14 and the Commission's rules thereunder grant the Commission discretion to determine whether a claim has been made that would be appropriate for a reparation proceeding. See section 14, of the Act and §§ 12.22, 12.25 and 12.31 of the Commission's rules, 41 FR 3994, 4001–02, 4003 (Jan. 27, 1976). Exercise of that discretion by the Commission in determining not to process a claim would not *ipso facto* be a basis for excluding a claim from an arbitration proceeding, since different standards and policies may apply in the arbitration proceeding (e.g. a violation of certain exchange rules may be the basis of an arbitration award, but may not support a reparation award if the particular rule is not a violation of the Commodity Exchange Act or rules thereunder).

[3] H.R. Rep. No. 93–975, 93d Cong., 2d Sess. 2–3 (1974). In its Federal Register notice announcing the adoption of rules of procedure under section 14 of the Act, the Commission stated:

> The Commission is of the opinion that the utilization of either an arbitration proceeding or civil court litigation is a waiver of the remedies available under the reparation procedures if the arbitrtaion proceeding or court litigation is pursued to a final decision on the merits. In order to prevent the utilization of the reparation procedures while an arbitration proceeding or civil court litigation is pending, based on the same facts set forth and against the same party or parties named in a complaint, the Commission has determined to require the complainant to set forth in the complaint any pending arbitration proceeding or court litigation based on the facts set forth and against the same party or parties named in the complaint. (§ 12.21(a)(7)). Should such an arbitration proceeding or court litigation be pending at the time the reparation complaint is filed with the Commission, the Commission will ordinarily stay the reparation proceeding pending a decision by the arbitration panel or court.

41 FR 3994 (January 27, 1976).

those heretofore signed by customers. The Commission specifically requests comments regarding whether notice should be given to customers that such agreements will be null and void. In those circumstances where a customer prior to the effective date of amended proposed rule § 180.3 has sought or seeks reparations before an arbitration proceeding has been substantially completed, the Commission believes that the customer has a right under the Commodity Exchange Act from and after January 23, 1975, to seek reparations for violations of the Act. In other circumstances, the Commission believes its views can best be made known in the context of the individual cases which arise. In those cases, such facts as whether the customer was advised of reparations before submitting to arbitration, the stage of completion of the arbitration proceeding, and whether the customer participated in any arbitration proceeding should be given consideration and may militate against the requirement that reparations take precedence over arbitration. For example, where a customer has voluntarily submitted to arbitration and was accorded a full hearing, the Commission does not intend to challenge such actions where the customer had not sought reparations prior to the arbitration proceeding.

In consideration of the foregoing, the Commission hereby proposes to amend Part 180, Chapter I of Title 17 of the Code of Federal Regulations by adding a new § 180.3 as follows:

§ 180.3 Voluntary procedure and compulsory payments.

(a) The use by customers of the procedure established by contract markets pursuant to the Act or this Part shall be voluntary. The procedures so established shall prohibit any argeement or understanding pursuant to which customers of members of the contract market agree to submit claims or grievances for settlement under said procedures prior to the time when the claim or grievance arose, except in accordance with paragraph (b) of this section.

(b) No futures commission merchant, floor broker, associated person or any other person registered with the Commission under the Act shall enter into any agreement or understanding with a customer in which the customer agrees to submit a claim or grievance, pertaining to any matter or transaction subject to the jurisdiction of the Commission, to any settlement procedure prior to the time when the claim or grievance arose, except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by the futures commission merchant or other registered person;

(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the warning and other provisions specified herein;

(3) The customer must be advised in writing that he or she may seek reparations under section 14 of the Act by an election made within 30 days after the futures commission merchant or other registered person notifies the customer that the registered person intends to demand arbitration under the agreement. This notice must be given at the time when the futures commission merchant or other registered person notifies the customer of its intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the preexisting arbitration agreement and must also be advised that aspects of the claims or grievances that are not subject to the reparations procedure (i.e. do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the preexisting arbitration agreement.

(4) The customer agreement must contain the following cautionary language printed in large bold-face type:

WHILE THE COMMODITY FUTURES TRADING COMMISSION (CFTC) ENCOURAGES THE SETTLEMENT OF DISPUTES BY AREITRATION, IT REQUIRES THAT YOUR CONSENT TO SUCH AN AGREEMENT BE VOLUNTARY. YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [name of fcm]. See 17 CFR 180.1–180.6.

BY SIGNING THIS AGREEMENT, YOU MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW, BUT YOU ARE NOT WAIVING YOUR RIGHT TO ELECT LATER TO PROCEED PURSUANT TO SECTION 14 OF THE COMMODITY EXCHANGE ACT TO SEEK DAMAGES SUSTAINED AS A RESULT OF A VIOLATION OF THE ACT. IN THE EVENT A DISPUTE ARISES AND YOU ARE NOTIFIED THAT [name of fcm] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION, IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND YOU PREFER TO REQUEST A SECTION 14 "REPARATIONS" PROCEEDING BEFORE THE CFTC, YOU WILL STILL HAVE 30 DAYS IN WHICH TO MAKE THAT ELECTION.

(5) If the agreement specifies a forum for settlement other than a procedure established pursuant to section 5a(11) of the Act or this Part, the procedures of such forum must comply with the requirements of § 180.5 of this Part.

(c) The procedure established by a contract market pursuant to section 5a (11) of the Act or this Part may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (b) of this section or the agreement to submit the claim or grievance to the procedure was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(d) The procedure established by a contract market pursuant to the Act or this Part shall not establish any unreasonably short limitation period foreclosing submission of customers' claims or grievances or counterclaims (permitted by § 180.4 of this Part) by contract market members or employees thereof.

Interested persons may participate in this proposed rule-making proceeding by submitting comments in written form to the Commodity Futures Trading Commission, 2033 K Street, N.W., Washington, D.C. 20581, Attn: CCU. All comments received on or before July 26, 1976, will be considered before the Commission takes final action on the proposal. Copies of all comments received respecting the proposal will be available for inspection at the Commission's office in Washington, D.C.

(Secs. 5a(11) and 8a, Commodity Exchange Act, as amended, ("Act") 7 U.S.C. 7a(11), 12a)

Issued in Washington, D.C., on June 25, 1976.

By the Commission.

WILLIAM T. BAGLEY,
Chairman, Commodity Futures Trading Commission.

[FR Doc.76–19020 Filed 7–1–76;8:45 am]

governing contract market arbitration and other dispute settlement procedures, adopted by the Commission on June 25, 1976. See 41 FR 27520 (July 2, 1976).

Section 180.1(a) which defines the term "claim or grievance," is amended by deleting from the first sentence the phrase "of the particular contract market which is the forum for the settlement procedure," and inserting in lieu thereof the phrase "of a contract market." Section 180.1(b), which defines the term "customer," is amended by striking that section and inserting in lieu thereof: "The terms 'customer' and 'customers' as used in this Part do not include members of the contract market where the claim or grievance arose."

These amendments are necessary to give full effect to § 180.3 of the Commission's rules governing contract market arbitration and other dispute settlement procedures, adopted by the Commission on September 14, 1976. See 41 FR 42942, September 29, 1976. The Commission adopted § 180.3 in order to make arbitration voluntary on the part of all customers, without regard to whether the futures commission merchant or other registered person was a member of a contract market. Under a literal interpretation of § 180.1(b), however, only customers of members would be "customers" for purposes of the Commission's rules, so customers of non-members technically would not have been protected by § 180.3. There were several other technical problems created by the definitions of customer and claim or grievance. For example, under § 180.1(b), a person would not have been a "customer" unless he was a person with a "claim or grievance," so it technically would have been permissible for registrants to enter into arbitration agreements with any person who did not then have a claim or grievance without regard to the requirements of § 180.3. And, under § 180.1(a), a dispute involving transactions executed on a contract market technically would not be a "claim or grievance" if there were an agreement for arbitration by the American Arbitration Association or other non-contract market forum, and the dispute, therefore, would be outside the scope of the Commission's rules. The Commission believes that any confusion which might be created by § 180.1 should be eliminated before the rules governing contract market arbitration and other dispute settlement procedures become effective. For that reason, § 180.1 is amended by deleting the above-quoted phrases, which were inadvertently carried over from an earlier draft of the rule.

These amendments are not intended to impose any new obligations on contract markets. In this connection, the Commission wants to make clear that, under § 180.2, contract markets are required to establish fair and equitable procedures for the settlement of customer's claims or grievances not in excess of $15,000 solely against any member or employee of a contract market.

In consideration of the foregoing, the Commission hereby revises § 180.1 of Chapter I, Part 180, of Title 17 of the Code of Federal Regulations to read as follows:

§ 180.1 Definitions.

(a) The term "claim or grievance" as used in this Part shall mean any dispute which arises out of any transaction on or subject to the rules of a contract market, executed by or effected through a member of that contract market or employee thereof which dispute does not require for adjudication the presence of essential witnesses or third parties over whom the contract market does not have jurisdiction and who are not otherwise available. The term claim or grievance does not include disputes arising from cash market transactions which are not a part of or directly connected with any transaction for the purchase or sale of any commodity for future delivery.

(b) The terms "customer" and "customers" as used in this Part do not include members of the contract market where the claim or grievance arose.

Section 180.1, as amended, will become effective November 29, 1976. The Commission encourages interested persons to submit written comments or suggestions on the amended rule. Materials submitted will be evaluated and considered with a view to further amendment in appropriate cases. Comments should be directed to the Commodity Futures Trading Commission, 2033 K Street, N.W., Washington, D.C. 20581, Attn: Secretariat.

(Secs. 8a(11) and 8a of the Commodity Exchange Act, as amended 7 U.S.C. §§ 7a(11), 12a (Supp. IV, 1974).)

Issued in Washington, D.C. on September 24, 1976.

By the Commission.

WILLIAM T. BAGLEY,
Chairman, Commodity Futures Trading Commission.

[FR Doc.76-28482 Filed 9-28-76;8:45 am]

Title 17—Commodity and Securities Exchanges

CHAPTER I—COMMODITY FUTURES TRADING COMMISSION

PART 180—ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES

Definitions

The Commodity Futures Trading Commission is amending § 180.1 of its rules

PART 180—ARBITRATION OR OTHER DISPUTE SETTLEMENT PROCEDURES

Voluntary Procedure and Compulsory Payments

On June 25, 1976, the Commodity Futures Trading Commission ("Commission") proposed a rule governing certain aspects of contract market arbitration and other dispute settlement procedures, which was published in the FEDERAL REGISTER (41 FR 27526 (July 2, 1976)).[1] The proposed rule, designated as § 180.3 of the Commission's regulations, would (1) require that the use by commodity customers of contract market arbitration or other dispute settlement procedures be voluntary; and (2) prohibit agreements between customers and fu-

[1] On the same date, the Commission published final rules with respect to other aspects of contract market arbitration or other dispute settlement procedures. See 41 FR 27520 (July 2, 1976).

tures commission merchants or other persons registered with the Commission which, prior to the time any claim or grievance has arisen, would require submission of future claims or grievances to a binding arbitration procedure, unless the agreement met certain prescribed conditions. Interested persons were given until July 26, 1976, to submit written comments on the proposed rule. After carefully considering all the comments received, the Commission has decided to adopt § 180.3 with the minor modifications set forth in this notice.

In a statement published in the FEDERAL REGISTER on July 10, 1975, the Commission first interpreted Section 5a(11) of the Commodity Exchange Act, as amended (the "Act"),[2] to mean that a contract market was not permitted to require a customer to agree, prior to the time a claim arose, to submit a future claim covered by that section to arbitration or other settlement procedure.[3]

The Commission thereafter published proposed rules governing contract market arbitration and other dispute settlement procedures on August 14, 1975.[4] Consistent with the Commission's prior interpretative statement, one of the rules then proposed, denominated as § 200.3, provided in subparagraph (a) that the use of the contract market settlement procedure by customers was to be voluntary and subparagraph (b) that contract market procedures bar pre-dispute arbitration agreements. In addition, proposed § 200.3(c) barred futures commission merchants, floor brokers and other persons registered with the Commission from entering into pre-dispute arbitration agreements or understandings with customers.[5] The Commission received comments strongly criticizing the proposed rules—particularly proposed § 200.3(c).[6]

As a result, on November 24, 1975, the Commission published amended proposed rules governing contract market arbitration and other dispute settlement procedures.[7] Previously proposed rule § 200.3 (redesignated as § 180.3) was amended so that it did not apply to claims or grievances which arose before adoption of the proposed rule; however, no new agreements containing pre-dispute arbitration clauses were to be allowed after the effective date of the proposed rule and existing agreements for pre-dispute arbitration were to be null and void one year after the effective date of the rule. The Commission received a number of comments on its amended proposed rules, including oral and written presentations at a hearing held on March 5, 1976, in Washington, D.C.[8]

The Commission thereafter adopted most of the rules governing arbitration and other dispute settlement procedures in substantially the same form as previously proposed; these rules, §§ 180.1, 180.2, 180.4, 180.5, and 180.6, were to be effective September 30, 1976.[9] At the same time, the Commission, after considering comments on its then proposed § 180.3, decided further to amend that rule proposal and to seek additional comment from interested persons.

As then amended, proposed § 180.3 would have (1) required that the use by commodity customers of contract market arbitration or other dispute settlement procedures be voluntary, and (2) permitted the use of pre-dispute arbitration agreements under certain prescribed conditions, but otherwise prohibited them. Briefly, four conditions were set forth: (1) The customer would not be forced to sign the agreement as a condition of doing business with the futures commission merchant or other registered person; (2) the customer would be given specific written cautions as to the effect of the agreement he was signing, and if the arbitration agreement was a part of a broader customer account agreement, the customer would separately endorse the cautionary clauses; (3) if a dispute covered by the agreement subsequently arose and the futures commission merchant or other registered person intended to submit the dispute to arbitration, the customer would then be given a written notice to the effect that he could ask for a reparations proceeding under section 14 of the Act, if the customer elected to do so within 30 days; and (4) the customer could not be required to agree to submit a future dispute to arbitration or other settlement procedures which did not comply with the requirements of § 180.5, that is, the procedures were required to be fair, equitable and voluntary.

The Commission received a number of comments on amended proposed § 180.3. The comments were, for the most part, favorable; however, there were several comments critical of proposed § 180.3(b), the provision dealing with pre-dispute arbitration agreements:

(1) The American Arbitration Association and two other commentators expressed concern that the bold-faced[10] cautionary language required by proposed § 180.3(b)(4) would be in the nature of a warning against use of an arbitration procedure and would thus discourage persons from signing pre-dispute arbitration agreements.[11] "Such warnings are not usual in commercial contracts," and "can only result in frightening away some customers." These commentators suggested that requiring the cautionary language was inconsistent with the Commission's expressed desire to encourage settlement of disputes by arbitration, and they recommended that such language be deleted from proposed § 180.3.[12]

The Commission has expressly indicated its positive attitude toward the settlement of disputes by arbitration. It does not follow from this, however, that the Commission can or should leave a customer unaware of the purpose of the agreement he is requested to sign. Although the Commission's proposal would not prohibit the use of pre-dispute arbitration agreements, the Commission believes that cautionary language is necessary to assure an informed consent on the part of the customer at the time he enters into the arbitration agreement.

---

[2] Section 5a(11) of the Act states that each contract market shall: Provide a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof: *Provided*, That (i) the use of such procedure by a customer shall be voluntary, (ii) the procedure shall not be applicable to any claim in excess of $15,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties, and (iv) the term "customer" as used in this paragraph shall not include a futures commission merchant or a floor broker . . . 7 U.S.C. § 7a(11) (Supp. IV, 1974).

[3] 40 FR 29121 (July 10, 1975). The Commission also noted, however, that: If a customer agrees to submit his claim to arbitration after the dispute arose and agrees under applicable state law, submission agreement or otherwise to be bound by the award of the arbitrators or other decision-making body, the Commission believes that the award is binding, in accordance with applicable state law. *Id.* at 29122.

[4] 40 FR 34152 (August 14, 1975).

[5] The rule was proposed under the general rulemaking authority of the Commission under section 8a(5) of the Act in order to effectuate the legislative intent, evidenced by section 5a(11), to make arbitration voluntary on the part of customers, without regard to whether the futures commission merchant or other registered person executing transactions for the customer was a member of a contract market, or was submitting a dispute for settlement pursuant to a contract market settlement procedure established under the Commission's rules or to another type of arbitration or dispute settlement procedure.

[6] Those comments are summarized at 40 FR 54430, 54432–33 (November 24, 1975).

[7] 40 FR 54430 (November 24, 1975).

[8] Notice of this hearing was published in the FEDERAL REGISTER on February 11, 1976. 41 FR 5120 (February 11, 1976).

[9] 41 FR 27520 (July 2, 1976). However, as noted *infra* page 20, the effective date of these rules has been postponed until sixty days after the date of publication in the FEDERAL REGISTER.

[10] One commentator said "[t]here is no objection, however, to the requirement that an arbitration clause contained in a brokerage contract be printed in large or bold-faced type so that the clause is clearly distinguishable from other clauses of that agreement. Some [futures commission merchants] use such a format now to insure that a customer is aware of the clause."

[11] The American Arbitration Association suggested that a more balanced approach would be to: (1) simply provide that arbitration agreements shall be voluntary; (2) assure that investors who refuse to sign arbitration agreements cannot be solely for that reason restricted from trading; (3) provide that even where there is a binding agreement to arbitrate, the customer may elect to seek reparations instead, and (4) permit this option to be exercised by the customer before requesting arbitration or within 30 days after the claim or grievance arises.

[12] Another commentator suggested that the Commission's rule should only require futures commission merchants to notify customers at the time arbitration is demanded that the reparations procedures are available in any dispute involving a violation of the Act. However, the Commission is also concerned that customers not unknowingly or unwittingly relinquish their right to sue in a court of law.

The Commission is not persuaded, therefore, that it should delete the cautionary language requirement from proposed § 180.3(b). And there is no reason to suppose that the proposed language would have any substantial effect on a customer's decision concerning arbitration after a claim or grievance arises. In those situations, the decision whether to arbitrate is typically based on the advice of legal counsel or an independent evaluation of the benefits of arbitration as opposed to litigation or reparations. Accordingly, the Commission has decided to retain the requirement of cautionary language in pre-dispute arbitration agreements.

(2) Another commentator stated that most customers would do no more than glance over the cautionary language and sign it, and even if they did read the caution they could not understand it because of its legal phraseology.[12] This commentator suggested that the cautionary language should either be deleted or its language revised so that the customer could understand precisely what rights he would be forgoing if he agrees to arbitration. While the Commission is of the view that the legal implications of the proposed language could be spelled out in all their ramifications, it would be virtually impossible to do so in less than several highly technical paragraphs. The result would be a longer and perhaps more confusing document. Accordingly, the Commission has opted for a short, concise statement, which it believes focuses on the significant aspects of the customer's rights in understandable form. It is assumed that, in most instances, if the customer does not understand the meaning of the cautionary language, advice will be sought by the customer from competent counsel.

(3) The Futures Industry Association and two other commentators raised a number of legal issues concerning proposed § 180.3(b):

(A) These commentators said that the Commission has no authority to abrogate existing arbitration agreements which do not comply with proposed § 180.3(b), and suggested that such action would be unreasonable, violative of due process, and unconstitutional both as an impairment of the obligations of contracts and as an *ex post facto* law. After careful analysis, the Commission has determined that these contentions have no legal merit.

It is well-settled that the freedom of contract protected under the due process clause of the Fifth Amendment is qualified in that, so long as the regulation is reasonably necessary to carry out statutory purposes, that regulation can forbid certain contracts or require certain clauses to be read into or become part of private contracts.[14] The Commission is convinced that, as a legal matter, courts would strike down pre-dispute arbitration agreements currently in effect in the commodities business since such clauses have the effect of negating the remedial provisions of sections 5a(11) and 14 of the Act and are signed in an atmosphere which imports a lack of informed consent on the part of certain unsophisticated customers under circumstances which may well be viewed by courts as the imposition of a contract of adhesion to the detriment of such customers. Consequently, the Commission believes that no violation of due process is inherent in requiring pre-dispute arbitration agreements to satisfy the conditions set forth in the Commission's rules.

The prohibition in Article I, section 10 of the United States Constitution against impairment of the obligations of contracts applies to the states, not to the Federal government.[15] Since the Act is a law regulating interstate commerce and the regulations thereunder are presumed necessary and reasonable, it would be constitutionally unobjectionable if there were an incidental impairment of private contract obligations,[16] assuming that invalidation of mandatory arbitration provisions, in the absence of customer waiver, constitutes an impairment.

The prohibition in Article I, section 9 of the United States Constitution against *ex post facto* laws applies to criminal, not civil legislation.[17] Since the § 180.3(b) does not make it a crime to sign a pre-dispute arbitration agreement (or increase punishment or alter the rules of evidence or judicial procedure in a way that would disadvantage a registrant in a criminal proceeding), it would be constitutionally unobjectionable if it should incidentally have a retrospective effect on arbitration agreements.

Therefore, the Commission has determined that, on the effective date of proposed § 180.3(b), all pre-dispute arbitration agreements that do not satisfy the conditions set forth in the proposed rule will be null and void, including those heretofore signed by customers.[18]

(B) These commentators said that part of the cautionary language required by proposed § 180.3(b) "By signing this agreement you may be waiving your right to sue in a court of law, but you are not waiving your right to elect later [to seek reparations]" may be a misstatement of the law. The gist of their argument was that (1) the question whether a pre-dispute arbitration agreement creates a waiver of the right to seek reparations must be decided by Federal and state courts on a case-by-case basis and (2) the courts probably would not invalidate such an arbitration agreement because of (A) a judicial policy, supported by section 2 of the Federal Arbitration Act, of favoring arbitration and (B) the lack of an express statutory provision in the Commodity Exchange Act comparable to that in the Securities Act of 1933 barring waiver of statutory rights.

The Commission disagrees that this question must necessarily be answered on a case-by-case basis. The legislative history of the Act indicates that Congress "expected the Commission to publish regulations" "to implement and coordinate" reparations and other dispute settlement procedures "and their utilization and availability for resolution of disputes."[19] Furthermore, in direct contrast to such commentators, the Commission believes that a court would not uphold currently extant pre-dispute arbitration agreements (if all the issues were before the court), notwithstanding the policy in favor of arbitration enunciated in the Federal Arbitration Act and the lack of an express statutory provision in the Act comparable to the Securities Act of 1933, the basis upon which *Wilko* v. *Swan*, 346 U.S. 427 (1953), was decided. This belief

---

[12] This commentator added that he did not agree with the Commission's view that arbitration was a quick and less costly method of resolving disputes and expressed concern about the lack of discovery procedures, the informal rules of evidence, and the fact that complicated questions of law may be decided by non-lawyers in arbitration proceedings. He concluded that the Commission should not give its "official boid-face imprimatur" to arbitration provisions. The Commission, however, is not persuaded that the informal nature of these proceedings necessarily makes them unfair and believes that usually such procedures are efficacious methods of settling disputes. However, the Commission has amended the cautionary language, as set forth below.

Another commentator said that "it is not a desirable practice for governmental agencies to prescribe the wording of [private] contracts." The Commission does not take issue with this comment, but believes that proposed § 180.3 is necessary to achieve an informed consent without which it believes the public policy evidenced by the Act would be thwarted.

[14] *See, e.g.*, Home Bldg. & Loan Assoc. v. Blaisdell, 290 U.S. 398 (1934). O'Gorman & Young, Inc. v. Hartford Fire Ins. Co., 282 U.S. 251 (1931); Chicago, B. & Q. R. Co. v. McGuire, 219 U.S. 549 (1911); *See also* Hardware Dealers Mutual Fire Ins. Co. v. Glidden Co., 284 U.S. 151 (1931); Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32 (1940).

[15] U.S. Const. art. I, section 10.

[16] *See, e.g.*, Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry., 294 U.S. 648 (1935).

[17] *See, e.g.*, Calder v. Bull, 3 Dall. 386 (1798). *See generally* 1 C. Antieau, *Modern Constitutional Law* sections 5:133–139 (Law Co-op 1969). The Supreme Court has consistently held that not all retrospective civil statutes are unconstitutional, but only those which, upon a balancing of the considerations on both sides, are felt to be unreasonable. *See, e.g.*, Chase Sec. Corp. v. Donaldson, 325 U.S. 304 (1945); League v. Texas, 184 U.S. 156 (1902). *See generally*, Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692 (1960). *See also supra* note 14 accompanying text.

[18] The Commission wishes to note that it carefully considered the alternative to invalidating pre-dispute arbitration agreements suggested by these commentators—to limit proposed § 180.3(b) to agreements entered after the effective date of the proposed rule. However, the Commission believes that customers who have already signed arbitration agreements may need the protection afforded by proposed § 180.3(b) as much as customers who may enter arbitration agreements in the future, and is not persuaded that the convenience of futures commission merchants and other registrants is a sufficient reason to discriminate between customers on the basis of when they signed arbitration agreements.

[19] H.R. Rep. No. 93-975, 93rd Cong., 2d Sess. 22 (1974).

is based upon the following: (1) Since pre-dispute arbitration agreements are used by the entire industry, such agreements would effectively preclude a customer from seeking reparations as provided in section 14 of the Act; would negate the meaning of "voluntary" in section 5a(11) of the Act and would deprive commodity customers of private rights of action in courts of law under the Act; [9] thus depriving customers of the remedial effects of the 1974 amendments to the Act; (2) Since the Commission has been advised that futures commission merchants will not deal with customers who do not sign pre-dispute agreements,[10] there exists a pattern of systematic refusals to deal except in circumstances which eliminate certain basic rights of customers; and (3) Certain commodity customers who are unsophisticated are compelled to sign such agreements under conditions which suggest a lack of informed consent and the imposition of a contract of adhesion on them to their detriment.[11]

(C) These commentators said that the question whether the execution of an arbitration agreement is voluntary and a result of informed consent by a customer should be determined by courts on a case-by-case basis, not by the use of cautionary language.

Proposed § 180.3(b) did not, and was not intended to eliminate the role of courts in assuring that the execution of an arbitration agreements is voluntary. Rather, proposed § 180.3(b) sets certain minimum requirements for pre-dispute arbitration agreements (e.g., a prohibition on refusals to deal, cautionary language, etc.) to help assure an informed consent by customers. The courts still must decide whether the agreement was otherwise voluntary. The Commission recognizes the possibility that in some cases, the execution of pre-dispute arbitration agreements may be involuntary under applicable state or federal law, notwithstanding that the requirements of proposed § 180.3(b) are satisfied.

(D) These commentators expressed the view that the Commission's legal authority is limited to promulgation of rules concerning contract market arbitration procedures and that section 5a (11) of the Act does not authorize the Commission (1) to prohibit the use of pre-dispute arbitration agreements that "confer jurisdiction on alternative arbitration forums, such as the New York Stock Exchange or the American Arbitration Association," or (2) to "make § 180.5 of the Commission's rules applicable to all arbitration forums upon which the parties may confer jurisdiction other than [a contract market arbitration procedure]."

The Commission has previously stated that proposed § 180.3(b) would be adopted under the general rule-making authority granted to the Commission by section 8a of the Act, in order to effectuate the legislative intent of the 1974 amendments to the Act.[12] And, the provision that makes § 180.5 applicable to all arbitration forums is not, as these commentators suggested, tantamount to imposing the Commission's jurisdiction and procedural requirements on the New York court or on any other state court system. Proposed § 180.3(b)(5) simply prohibits pre-dispute arbitration agreements that would require a customer to submit a dispute for settlement pursuant to procedures that do not meet minimal safeguards for a fair and equitable procedure.

(E) Two of these commentators said that proposed § 180.3(b)(1), which would prohibit a registered person from refusing to do business with a customer solely because the customer declines to sign a pre-dispute arbitration agreement, "amounts to a denial of the fundamental freedom of contract;" contravenes the Constitutional prohibition against involuntary servitude; and "seems contrary to the recent public outcry against additional regulation."

The objective of proposed § 180.3(b)(1) is, of course, to assure "voluntary" agreements by customers to arbitrate. During the Commission's oral hearing on March 5, 1976, several futures commission merchants testified they would refuse to deal with persons who declined to sign binding arbitration agreements contained in customer account agreement forms. This practice, which the Commission believes may be followed by a substantial segment of the entire industry, effectively precludes a voluntary act by customers, since they are frozen out of the market unless they sign pre-dispute arbitration forms. The Commission carefully weighed these considerations and believes that its requirements are necessary in light of the concerted refusal to deal. Thus the Commission is not persuaded that proposed § 180.3(b)(1) amounts to the imposition of involuntary servitude or that it is an example of "over-regulation" by government. It is true that proposed § 180.3(b)(1) will affect contractual freedom, but it will serve to enhance, not restrict, the freedom of contracting parties for whose protection relevant provisions of the Act were adopted: "Freedom of contract" does not include freedom for one party to impose contracts of adhesion upon others. The Commission believes that in view of the legislative history of the Act, particularly of the 1974 amendments, and the testimony adduced at the Commission's March 5, 1976 hearing, the proposed rule is reasonably necessary to accomplish the objectives of the Act. Therefore, the Commission has determined to exercise its general rule-making authority under section 8a of the Act by adopting § 180.3(b)(1) in substantially the same form as previously proposed.

(5) Several commentators said that it would be very expensive for futures commission merchants to comply with proposed § 180.3(b); it was estimated that the costs of printing new arbitration agreements, mailing and follow up correspondence to assure a response and other related expenses would be between $7,000 and $11,000 for a futures commission merchant with a significant amount of commodity customers. The Futures Industry Association suggested that the Commission allow registrants to use a "negative option letter", a letter stating that unless the customer responds negatively within some period of time, their arbitration agreement will be deemed to be modified so as to conform the same in all respects with the Commission's rules. If this would be less costly than a positive affirmation, the Commission would not object to the use of a negative option letter in the case of existing arbitration agreements, provided the customer is fully apprised of the terms of the modified arbitration agreement. All new customer agreements will, of course, incorporate the new requirements.

(6) There was also criticism of the requirement in proposed § 180.3(b)(3) that a customer elect to seek reparations within 30 days after the futures commission merchant or other registered person notifies the customer that the registrant intends to demand arbitration under the agreement. One commentator said that, as a practical matter, customers could not be expected to act within 30 days, particularly if they seek legal counsel, and suggested that the period should be extended to 90 days. Another commentator said that the thirty-day waiting period could be easily confused with the twenty-day period provided by New York law for filing an application in court to stay arbitration, and suggested that proposed § 180.3(b)(3) be amended to conform to New York law.

The Commission has amended proposed § 180.3(b)(3) and the cautionary language in § 180.3(b)(4) to require that a customer elect reparations within 45 days. The Commission now believes that 20 or 30 days is too short a period, but that a 90-day period would undermine one of the purposes of arbitration—the prompt settlement of disputes. The Commission does not believe that conforming the time period to New York law would eliminate any confusion that might exist, since other states no doubt have different time periods than those provided by New York law.

(7) One commentator suggested that, consistent with the Congressional intent evidenced by section 5a(11) of the Act, customers should have the ability to demand that futures commission merchants and other registrants submit a dispute to contract market arbitration or other dispute settlement procedures

---

[9] *See, e.g.*, Case & Co., Inc. v. Board of Trade of the City of Chicago, 523 F.2d 355, 360 (7th Cir. 1975); Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967).

[10] See 41 Fed. Reg. 5120 (February 11, 1976).

[11] Moreover, courts will frequently defer to the contemporaneous construction given to a regulatory statute by an agency entrusted with its enforcement. See Power Reactor Development Co. v. International Union of Electrical, Radio and Machine Workers, 367 U.S. 396, 408 (1961).

[12] 40 F.R. 54430 (November 24, 1975).

without regard to or in the absence of any arbitration agreement between the customer and registrant. As adopted, Part 180 does not contain a provision that a contract market require its members, at the behest of customers, to submit disputes for settlement under the procedures established by the contract market under section 5a(11) of the Act irrespective of any arbitration agreement between the customer and the member.

The Commission believes that if contract markets establish procedures which do not contain such a requirement, the purpose of section 5a(11)—to provide customers with a contract-market forum to settle disputes—could be frustrated by members who choose to ignore the procedures. The Commission leans to the view that contract markets should impose such a requirement on their members. However, the Commission requests comment on (1) the need for the Commission to amend Part 180 so as to require contract markets to impose such requirements on their members and (2) whether such an amendment would be consistent with the voluntary nature of arbitration contemplated by section 5a (11).

(8) One commentator [illegible]at it appeared that proposed § 18[illegible]ld encompass the arbitration of disputes on foreign exchanges, such as the London Metals Exchange. The Commission's rules relating to arbitration and other dispute settlement procedures were intended to be and are applicable only to claims or grievances arising out of transactions effected on contract markets—that is, boards of trade designated as contract markets by the Commission under the Act. To make this absolutely clear, the Commission is concurrently amending § 180.1 so as to clarify the scope of the terms "claim or grievance" and "customer."[26]

In addition to the amendments that have been made as a result of the comments discussed above, the Commission made a number of minor and technical changes in the text of § 180.3, as follows:

AMENDMENTS TO § 180.3(a)

The first sentence of § 180.3(a) was amended by adding the phrase "or of the arbitration or other dispute settlement agreements specified in an agreement under subparagraph (b)(3) of this section" before the words "shall be voluntary." Previously proposed § 180.3(b) implicitly made "voluntariness" a requirement for all customer dispute settlement procedures covered by the rule, not just the procedures established by contract markets, and the new phrase simply states that requirement.

AMENDMENTS TO § 180.3(b)

Section 180.3(b) has been amended by deleting from the first sentence the phrase "or any other person registered with the Commission under the Act." The Commission did not intend that § 180.3 apply to commodity trading advisors or commodity pool operators: the phrase "or any other person registered with the Commission * * *" was inadvertently carried over from an earlier draft of the proposed rule, and has thus been deleted. However, the Commission intends to consider adopting rules governing the settlement of disputes between customers and commodity trading advisors and pool operators at a later date.

Proposed § 180.3 b) has also been amended to make clear that predispute arbitration agreements are invalid to the extent that they require a waiver of the right to seek reparations: the reparations remedy can only be waived after a dispute arises. The previously proposed rule indirectly stated this in § 180.3(c)(3) and in the cautionary language required by § 180.3(c)(4); however, a new introductory sentence to § 180.3(c)(3) has been adopted to eliminate any confusion about the effect of the rule in this regard.

AMENDMENTS TO § 180.3 (c) AND (d)

Paragraphs (c) and (d) are the same as previously proposed §§ 180.3 (c) and (d), respectively. In this connection, it should be noted, however, that the Commission is amending the terms "claim or grievance" used in these paragraphs and defined in § 180.1(a). See 41 FR 42942, September 29, 1976. The amendment deletes the phrase "which is the forum for the settlement procedure" in the first sentence of that section. That phrase was inadvertently carried over from an earlier draft of the proposed rule. It creates a possibly confusing ambiguity and, accordingly, has been deleted. The amendment does not affect any substantive rights under paragraphs (c) and (d).

Rule § 180.3 will become effective November 29, 1976. Since it would be in the public interest for all the Commission's rules governing contract market arbitration and other dispute settlement procedures to become effective on the same date, the Commission has decided to delay the effective date of rules §§ 180.1, 180.2, 180.4, 180.5 and 180.6 as well.

In consideration of the foregoing, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations by adding a new § 180.3 to Part 180, as follows:

§ 180.3 Voluntary procedure and compulsory payments.

(a) The use by customers of the dispute settlement procedures established by contract markets pursuant to the Act or this Part or of the arbitration or other dispute settlement procedures specified in an agreement under paragraph (b)(3) of this section shall be voluntary. The procedures so established shall prohibit any agreement or understanding pursuant to which customers of members of the contract market agree to submit claims or grievances for settlement under said procedures prior to the time when the claim or grievance arose, except in accordance with paragraph (b) of this section.

(b) No futures commission merchant, floor broker or associated person shall enter into any agreement or understanding with a customer in which the customer agrees, prior to the time the claim or grievance arises, to submit such claim or grievance to any settlement procedure except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by the futures commission merchant, floor broker or associated person;

(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and other provisions specified in this section;

(3) The agreement may not require the customer to waive the right to seek reparations under Section 14 of the Act and Part 12 of these regulations. Accordingly, the customer must be advised in writing that he or she may seek reparations under Section 14 of the Act by an election made within 45 days after the futures commission merchant, floor broker or associated person notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when the futures commission merchant, floor broker or associated person notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the preexisting arbitration agreement and must also be advised that aspects of the claims or grievances that are not subject to the reparations procedure (i.e. do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the preexising arbitration agreement.

(4) The customer agreement must contain the following cautionary language printed in large bold-face type:

WHILE THE COMMODITY FUTURES TRADING COMMISSION (CFTC) RECOGNIZES THE BENEFITS OF SETTLING DISPUTES BY ARBITRATION, IT REQUIRES THAT YOUR CONSENT TO SUCH AN AGREEMENT BE VOLUNTARY. YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [name]. See 17 CFR 180.1–180.6.

BY SIGNING THIS AGREEMENT, YOU MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW, BUT YOU ARE NOT WAIVING YOUR RIGHT TO ELECT AT A LATER DATE TO PROCEED PURSUANT TO SECTION 14 OF THE COMMODITY EXCHANGE ACT TO SEEK DAMAGES SUSTAINED AS A RESULT OF A VIOLATION OF THE ACT. IN THE EVENT A DISPUTE ARISES, YOU WILL BE NOTIFIED IF [name] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION. IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND IF YOU PRE-

[26] Rules 180.1, 180.2, 180.4, 180.5 and 180.6 will now go into effect at the same time as Rule 180.3—sixty days after publication in the FEDERAL REGISTER. See 41 FR 42947, September 29, 1976.

FER TO REQUEST A SECTION 14 "REPARATIONS" PROCEEDING BEFORE THE CFTC, YOU WILL STILL HAVE 45 DAYS IN WHICH TO MAKE THAT ELECTION.

(5) If the agreement specifies a forum for settlement other than a procedure established pursuant to section 5a(11) of the Act or this Part, the procedures of such forum must comply with the requirements of § 180.5.

(c) The procedure established by a contract market pursuant to section 5a (11) of the Act or this Part may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (b) of this section or that the agreement to submit the claim or grievance was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(d) The procedure established by a contract market pursuant to the Act or this Part shall not establish any unreasonably short limitation period foreclosing submission of customers' claim or grievances or counterclaims (permitted by § 180.4 or this Part) by contract market members or employees thereof.

Although these rules become effective November 29, 1976, the Commission encourages interested persons to submit written comments or suggestions on the rules. Materials submitted will be evaluated and considered with a view to amendment in appropriate cases. Comments should be directed to the Commodity Futures Trading Commission, 2033 K Street, N.W., Washington, D.C. 20581, Attn: Secretariat.

(Sections 5a(11) and 8a of the Commodity Exchange Act, as amended ("Act"), 7 U.S.C. §§ 7a(11), 12a (Supp. IV, 1974).)

Issued in Washington, D.C. on September 24, 1976.

By the Commission.

WILLIAM T. BAGLEY,
Chairman, Commodity Futures Trading Commission.

[FR Doc.76-28481 Filed 9-28-76;8:45 am]

MR. CRAWFORD: In all of the claims filed in excess of $15,000 --

CHAIRMAN SCHNEIDER: About 10 --

MR. CRAWFORD: About half of them have counterclaims in excess of $15,000.

CHAIRMAN SCHNEIDER: What I'd like to get a feel for is, of the claims that were filed for, in excess of $15,000 in amount, how many of those have counterclaims which exceed $15,000 in amount? Approximately?

MR. CRAWFORD: That would be difficult to say but in general we found that in arbitrations, a good offense is the best defense and so I would have to say that it's certainly in the majority of those cases.

CHAIRMAN SCHNEIDER: Thank you. I'm sorry I interrupted Commissioner Dunn who was pursuing a point.

Do you want to go on, Read?

COMMISSIONER DUNN: I don't think there's any point in pursuing it. I think I understand.

CHAIRMAN SCHNEIDER: Commissioner Seevers.

COMMISSIONER SEEVERS: Mr. Crawford, I have one question about the meaning of "shall be voluntary." You're saying that our interpretation of "shall be voluntary" is erroneous in your judgment.

Do customers have a voluntary choice of signing the waiver or not signing the waiver in the case of your firm

7676 NEW HAMPSHIRE AVENUE, SUITE 210 • LANGLEY PARK, MARYLAND 20783 • (301) 439-5600

or other FCM's?

MR. CRAWFORD: The honest answer to that question is that I really don't know but I would suspect that a customer who x'd out the arbitration portion of his customer's agreement, which would be just one paragraph in the customer's agreement or x'd out any paragraphs in the customer's agreement, that were applicable to the type of transactions he was undertaking, and what I'm trying to say is that in many houses the customer agreement covers cash transactions and margin transactions and commodity transactions and option transactions and you do expect certain portions to be x'd out by some customers that are only doing cash transactions or only doing option transactions, but if someone was to open up a margin account and x out the lending agreement and x out the arbitration agreement we would not do business with them.

And I suspect that if he x'd out the arbitration agreement, we would also not do business with him.

COMMISSIONER SEEVERS: Thank you.

MR. CRAWFORD: Now, it's conceivable that there are houses, and there are houses that do not have arbitration agreements in their customer agreements.

CHAIRMAN SCHNEIDER: Don, if you don't mind I'd like to go on with a few more questions. We're running late but I think your testimony has been good and forceful and

7676 NEW HAMPSHIRE AVENUE, SUITE 210 • LANGLEY PARK, MARYLAND 20783 • (301) 439-5630

therefore, we'd like to pursue it for a couple more minutes, if we can.

Jerry, do you have another question? I'm sorry.

COMMISSIONER SEEVERS: Well, I'll just make the observation and I don't expect a response, but I don't see what meaning there is to "shall be voluntary" if the customer really doesn't have a choice.

MR. CRAWFORD: I have to disagree with you. "Shall be voluntary" is defined as in the statute 5 a (11) only defines a point in time and your staff has already said that, at which waiver is -- at which he may waive whatever rights he may have, either in the Federal Courts or in reparations proceedings, and your staff has already said that that waiver can occur once the events have happened.

Now, again I have to cite the example of the customer that in fact x's out the arbitration portion in that agreement, in his customer agreement. He is not willing to waive that at that point, but there are many other customers --

CHAIRMAN SCHNEIDER: And your solution is not to do business with him.

MR. CRAWFORD: Yes.

CHAIRMAN SCHNEIDER: Okay.

MR. CRAWFORD: But he may in fact make a conscious decision to waive it at that point and once that decision has

7676 NEW HAMPSHIRE AVENUE, SUITE 310 • LANGLEY PARK, MARYLAND 20783 • (301) 439-5600

fiduciary relationship to him rather?

MR. CRAWFORD: That's a very interesting question. We are, by the rules of the various clearing corporations for the various Exchanges, a principal with regards to the transactions that are on that particular Exchange, which then creates a situation where we are both simultaneously principal and agent and I believe that classic agency law cannot be applied to commodity situations because of the peculiarities of the clearing operation.

CHAIRMAN SCHNEIDER: I don't even mean to take it that far. I mean when a man walks in off the street or a woman walks in off the street and walks into your office and says I would like to open a commodity account, do you feel at that point in time that you have any fiduciary obligation to that particular customer?

MR. CRAWFORD: Before he executes any transaction?

CHAIRMAN SCHNEIDER: Before the execution of any transaction. In other words, do you have any obligation to that customer at all?

MR. CRAWFORD: Not when he walks in off the street.

CHAIRMAN SCHNEIDER: In other words, what you're saying, if I can interpolate it to this arbitration situation, you have no obligation to explain to that customer that he is waiving certain rights which he has available to him?

MR. CRAWFORD: I do not believe so.

7676 NEW HAMPSHIRE AVENUE, SUITE 210 • LANGLEY PARK, MARYLAND 20783 • (301) 439-5000

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581

OFFICE OF
THE GENERAL COUNSEL

August 19, 1977

A. Daniel Fusaro, Esquire
Clerk, United States Court of Appeals
for the Second Circuit
United States Courthouse
Foley Square
New York, New York 10007

Re: Ames v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., et al., No. 77-7192.

Dear Mr. Fusaro:

Enclosed for filing with the Court in the above-referenced case are an original and three copies of a MOTION OF THE COMMODITY FUTURES TRADING COMMISSION FOR LEAVE TO FILE A MEMORANDUM, AMICUS CURIAE in the above-referenced case and twenty-five copies of the MEMORANDUM OF THE COMMODITY FUTURES TRADING COMMISSION, AMICUS CURIAE. Since the Commission's motion appears to be a procedural motion under the terms of Circuit Rule 27(e), we are not noticing the motion for hearing.

I hereby certify that on August 19, 1977, I caused to be served by United States mail, two true copies of the motion and brief upon counsel for the parties as follows:

Lowenthal, Landau, Fischer & Singer, P.C.
250 Park Avenue
New York, New York 10017

James J. Dolan
165 Broadway
New York, New York 10006

Sincerely,

Joanne Leveque
Assistant General Counsel

Enclosures